# The Politics of Too Much:

# Essays on the Emergence and Persistence of Current-Account Surpluses

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# Chapter 1

# Synopsis

### 1.1 Introduction

Balance-of-payment issues are at the heart of most financial crises. Put simply, such issues arise as the result of fundamental imbalances in the current-accounts of major economies. In an imbalanced world, some countries build-up large current-account surpluses by exporting much more than they import and saving much more than they invest domestically. The surplus of goods and capital from these countries flows to economies with large current-account deficits. This second group of economies imports much more than it exports and finances the growing difference by borrowing more and more of the surplus savings from the first group (Chinn and Ito, 2007). What at first may sound like a dull accounting phenomenon can easily evolve into a rapid stream of capital and goods in which some countries import too much and amass more and more debt, whilst others export too much and readily provided the credit needed (Frieden and Walter, 2017). If current-accounts remain unhinged, debt crises in deficit countries are bound to erupt as soon as – for one reason or another – the capital flows underlying these imbalances dry up. Unfortunately, this is not uncommon. Persistent imbalances between the current accounts of major economies and the credit booms they fuel have brought down the Bretton-Woods system (Walter, 1991; James, 1996). They played a key role in the emerging market crises of the 1980s and 1990s (Frieden, 1991; Lane and Milesi-Ferretti, 2012; Breuer, 2004; Walter, 2013), they were a main driver of the financial crisis of 2008 (Obstfeld, 2012; Obstfeld and Rogoff, 2009) and they constituted a root cause of the debt crisis which over the last decade has shaken the Eurozone to its core and left it economically and politically vulnerable until today (Frieden and Walter, 2017; Baldwin and Giavazzi, 2015).

Even in times of financial calm, current-account imbalances are often responsible for deep political rifts between close economic partners. Long before Donald Trump turned the

I am grateful to Stefanie Walter, Lukas Haffert and Valentin Lang for their very helpful comments on the structure and substance of this introduciton.

current-account surpluses of China and Germany into a main justification for his return to trade wars (Fetzer and Schwarz, 2019), conflicts about the adjustment of balance-of-payment imbalances already weighed heavily on world politics in the inter-war years of the early 20th century (Simmons, 1997). They produced heated disputes between the US and Japan and Germany in the 1970s and 1980s (Kreile, 1977; Putnam, 1988; Kinderman, 2008), were a main liability for the European Monetary System (Frieden and Eichengreen, 2001; Frieden, 2015) and they remain one of the hardest bones of contention in the debates about the reform of the European Monetary Union (EMU) (Walter et al., 2019; Wasserfallen and Lehner, 2018). Balance-of-payment imbalances are, thus, a major source of international economic conflicts and crises. Yet, the fact that until today we know little about the causes of large and sustained balance-of-payment imbalances stands in stark contrast to their economic and political relevance and hampers effective political responses (Manger and Sattler, 2019). Against this background, this dissertation studies the institutional and political roots of the emergence and persistence of such imbalances.

In investigating the political and institutional drivers of large and persistent current-account imbalances, there are three common perspectives that guide the analyses of this cumulative dissertation: First, a substantive focus on current account surpluses. Second, a theoretical emphasis on the role of distributional considerations and conflicts in the built up and maintenance of such surpluses. Third, an attempt to put the rise of persistent current-account surpluses into the context of broader changes in the fundamental functioning of advanced capitalism. Regarding the first, much of the existing literature on the political economy of balance-of-payment imbalances is characterized by a strong focus on the role of current-account deficits (Manger and Sattler, 2019). On the one hand, a rich and insightful literature has studied the economic and political factors that lead countries to import more than they export and consume or invest more than they earn. This literature has shown how larger fiscal deficits (Volcker, 1984; Kearney and Monadjemi, 1990; Corsetti and Müller, 2006), higher levels of income inequality (Ahlquist and Answell, 2017; Belabed, Theobald and Treeck, 2018; Kumhof et al., 2012), higher levels of financial deepening (Chinn, Eichengreen and Ito, 2014; Brissimis et al., 2013) as well as more consumption oriented economic growth models (Baccaro and Pontusson, 2016; Hall, 2012; Iversen and Soskice, 2018) all contribute to the emergence of large current account deficits. On the other hand, research on the political economy of the adjustment of current-account imbalances also largely focuses on countries with negative current accounts. Deficit countries are usually hit the hardest when balance-of-payments crises erupt and, thus, are put under the most acute pressure to adjust their current accounts (Frieden and Walter, 2017). Often, the consequences are fierce domestic political battles over who has to bear the costs of adjustment and scholars have extensively studied the political and economic factors that impede or facilitate these adjustment processes. Most importantly, existing studies have pointed to the role that domestic political systems (Keefer, 2007; Haggardd and Kaufman, 1992), the relative exposure of important societal groups to different adjustment policies (Walter, 2013, 2016; Frieden, 2014), strong resistance by vested interest groups (Featherstone, 2015) as well as party politics and electoral considerations (Leblang, 2003; Hübscher and Sattler, 2017; Afonso, Zartaloudis and Papadopoulos, 2014) play in re-balancing current-account deficits.

Whereas existing research, thus, has largely advanced our understanding of the political economy of current-account deficits, we know much less about the ways in which politics and institutions shape the opposite side of the world's balance sheet (Manger and Sattler, 2019; Frieden and Walter, 2017). This is indeed surprising as, on the one hand, one country's deficit, by definition, is another country's surplus. Countries with large current-account surpluses export more than they import and, thus, are often accused of pricing competitors out of the market while contributing little to global demand. At the same time, they consume or invest less than they earn and, therefore, provide the rest of the world with cheap money, fueling excessive credit taking and speculative bubbles abroad. From a global macroeconomic perspective, this position is similarly destabilizing as running large current-account deficits (e.g. IMF, 2017*a*). Understanding what drives some countries to accumulate large current account surpluses and what keeps them from re-balancing their macroeconomic fundamentals even in times of large economic crises and stark international political pressure is, therefore, key for our understanding of the political economy of global imbalances.

Second, our lack of knowledge of the political economy of large current-account surpluses is also surprising as surplus countries, in recent years, have been the source of an important reconfiguration of global imbalances. The upper panel of Figure 1.1 maps all countries which at some point since 1980 have experienced periods of large and sustained current-account surpluses. It shows that prolonged surpluses have occurred in a large number of countries.

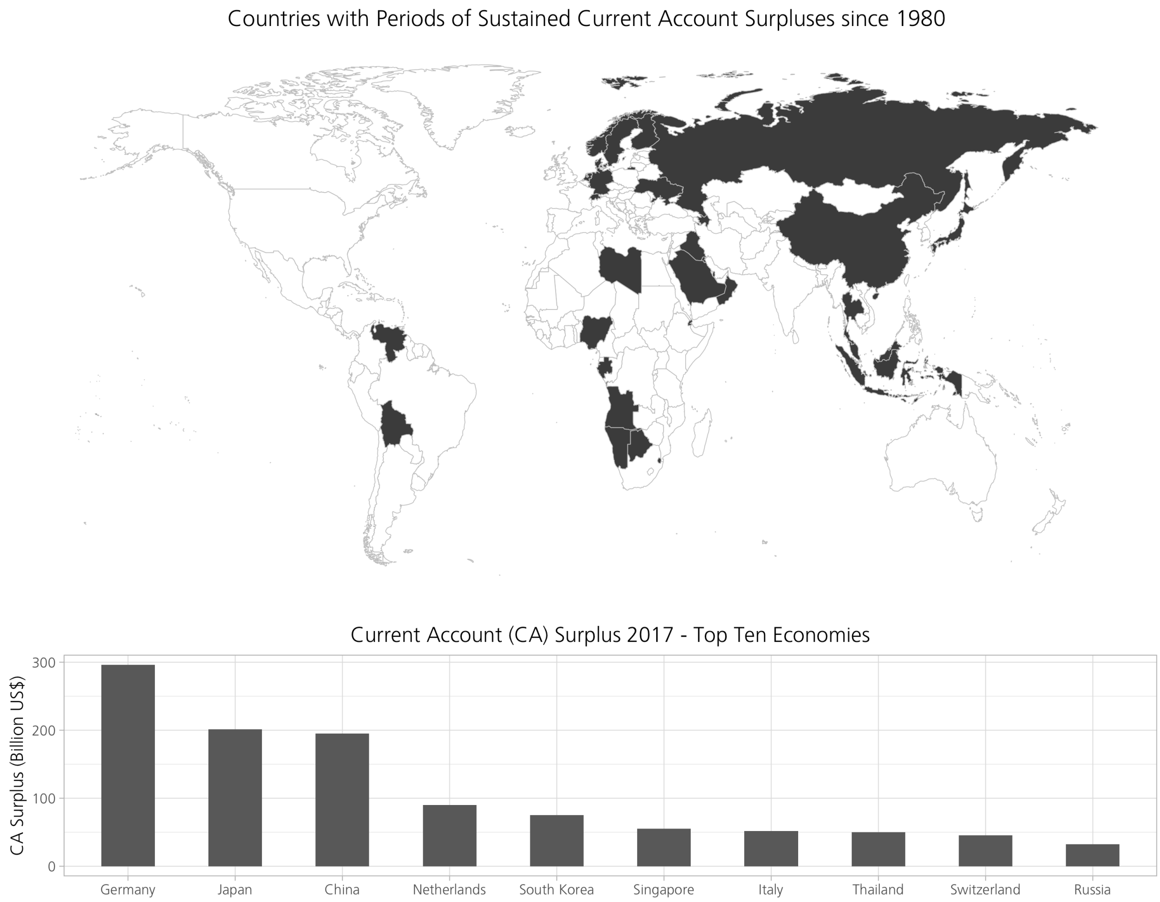


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Figure 1.1: Countries with Periods of Sustained Current Account Surpluses (defined as a surplus of more than 3% of GDP which is sustained for at least 5 years) and Ten Economies with the largest Current Account Surplus in 2017. Data from (IMF, 2018*b*).

However, especially in the late 1990s and early 2000s, big surpluses were often seen as a transitional phenomenon that resulted from oil exports and the export-oriented growth strategies of China and other emerging markets in East Asia (Dooley, Folkerts Landau and Garber, 2004; Dooley, Folkerts-Landau and Garber, 2009). In recent years, this pattern has changed. The lower panel of Figure 1.1 shows that in 2017, eight out of the ten countries with the largest current account surpluses were advanced economies. Surpluses are, thus, increasingly concentrated in the developed world, which makes it much less likely that these surpluses will simply dissolve in the process of economic catch-up growth and amplifies the need to understand the political economy of their emergence and persistence (see also IMF, 2018*a*). Against this background, this dissertation puts surplus countries front and center and broadly investigates two questions: First, what are domestic institutional factors that lead some countries to export more than they import and accumulate large savings? And second, what are the political factors that impede or facilitate current-account adjustment in surplus countries in times of balance-of-payments tensions?

In addition to a substantive focus on the surplus side of the balance sheet, a second core contribution of this dissertation is a theoretical emphasis on the role of distributional considerations and conflicts in the build-up of large and persistent current-account surpluses. Existing research often ascribes the emergence of overhangs in export and savings mainly to structural macroeconomic conditions and demographic changes (Gruber and Kamin, 2007, 2009; Chinn and Ito, 2008). Similarly, standard analyses of the political economy of current-account re-balancing give little considerations to distributional conflicts in surplus countries as – contrary to deficit states – countries with large savings and exports are under no inherent pressure to adjust (Frieden, 2015). However, current-account surpluses do have far reaching distributional implications (Frieden and Walter, 2017). Economies that export more than they import and save more than they consume or invest work in favor of some societal actors but, at the same time, also hurt the material interests of others. Similarly, the question of whether and how to reduce such surpluses concerns a multitude of policy areas ranging from issues of labor market regulations to tax policies and questions about public spending, every one of which produces winners and losers. A core objective of this dissertation is, therefore, to show that the emergence of large and persistent surpluses – as much as deficits – is shaped by distributional and political processes. Put differently, to understand the balance-of-payments positions of different countries, we need to understand the balance-of-power positions of the different societal actors that shape them.

Third, whereas questions pertaining to balance-of-payment imbalances are a main motivation for this dissertation, it also emphasizes that the phenomenon of persistent current-account surpluses has its roots in economic trends that have much broader implications for economic inequality and growth. In recent years, the rise of current-account surpluses in many countries was strongly associated with two important developments. An increase of the share of profits in national income (Dao et al., 2017; Autor et al., 2017; Bental and Demougin, 2010; Brennan, 2016) and a corresponding rise of corporate savings (Loeys et al., 2005; Gruber and Kamin, 2016; Sun and Wang, 2014; Chen, Karabarbounis and Neiman, 2017). As I will explain in more detail below, both these trends have important implications

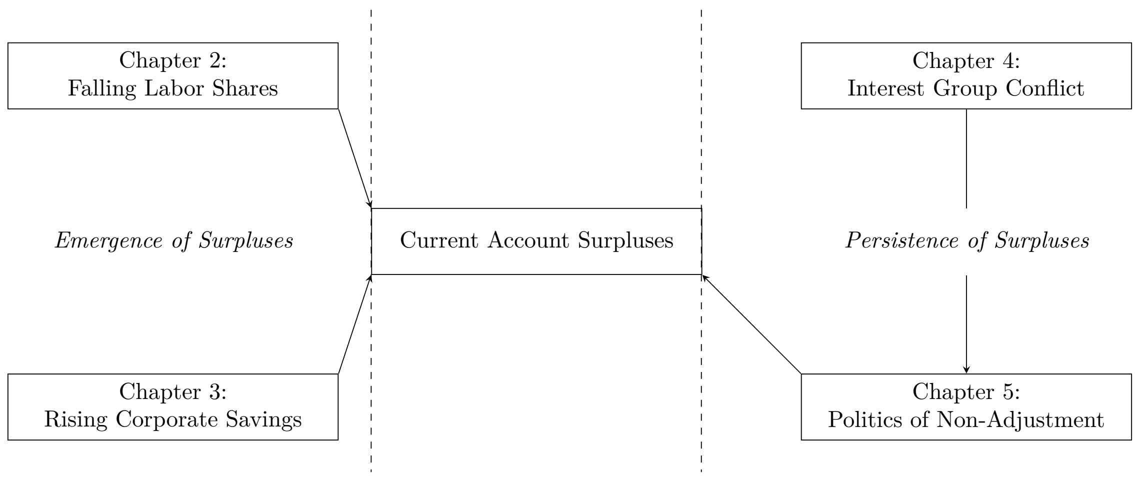


FIGURE 1.2: Dissertation Outline

for the balance of payments. The steeper the rise of profit shares and the more pronounced the turn towards corporate savings, the more likely countries are to accumulate large current-account surpluses. At the same time, both of these trends also have crucial implications for the fundamental functioning of modern capitalism. The rise of profits shares and the corresponding fall of the proportion of national income that ends up in the pockets of workers constitutes a key driver of economic inequality (Piketty, 2014). Similarly, the fact that firms increasingly retain their profits and stash them on financial markets has been a major drag on global growth and has heightened financial fragilities (Karabarbounis and Neiman, 2012). By studying how domestic institutions shape these two sources of current-account surpluses, this dissertation, thus, also adds to our understanding of important aspects of rising economic inequality and economic imbalances more generally.

The remainder of this synopsis describes the structure of this cumulative dissertation, summarizes its main findings and discusses their implications for academic research and policy-making. The next section gives a brief overview about the overall structure of this dissertation. The following sections discuss my arguments, empirical approaches and findings relating to the emergence and persistence of current-account surpluses in greater detail and put them into the broader context of existing work. Finally, I summarize the overall findings across all chapters and discuss their joint implications for research and politics.

## 1.2 Outline of the Dissertation

Before diving into the details of the separate chapters, Figure 1.2 provides a general overview of the overall structure of this cumulative dissertation. To study the political economy of the surplus side of economic imbalances, this dissertation consists of two parts and four chapters. The first two chapters are single authored and study factors that have contributed to the emergence of large current-account surpluses in recent years. Both chapters argue that, in order to understand the trends underlying the recent build-up of large current-account surpluses, we need to understand how global economic trends interact with changes in the efficacy of domestic labor-market institutions in shaping economic outcomes in the private sector. More specifically, Chapter 2 analyzes the institutional factors that in some countries have contributed to a fall of labor's share in national income and a corresponding rise of private sector profits. Chapter 3 then turns to investigating how changes in domestic labor-market institutions have allowed firms to increasingly refrain from paying out or reinvesting these surplus profits and instead accumulate huge amounts of savings. As I will discuss in more detail below, both of these trends constitute an important but often overlooked source of growing current-account surpluses and rising capital exports.

The first half of the dissertation, thus, studies the emergence of current-account surpluses by focusing on developments in the private sector. The second half then turns to politics and asks why policymakers in surplus countries have not done more to counter the trend of rising surplus exports and savings. More specifically, chapters 4 and 5 study political factors that inhibit or facilitate current-account adjustment in times of severe balance-of-payments crises. This part of the dissertation is based on a joint book manuscript with Stefanie Walter, Ari Ray and Raphael Reinke, which is forthcoming at Oxford University Press (Walter et al., 2019). Focusing on surplus countries in the Eurozone crisis, we investigate how distributional conflicts between major economic interest groups about policies that could contribute to decreasing current-account surpluses, such as public spending, tax cuts, wage policies and labor market regulation, make economic adjustment in surplus countries politically difficult (chapter 4). The final chapter (chapter 5) then investigates how these distributional conflicts amongst organized interests have interacted with the preferences of voters and the general economic climate in shaping adjustment in surplus countries. The following section gives a short overview of each chapter's main arguments, findings and a summary of how they speak to existing research on the subjects.

## 1.3 The Emergence of Current-Account Surpluses

My argument concerning the emergence of large current-account surpluses centers on the idea that domestic labor market institutions influence the balance of payments through their impact on the behavior of private firms. More specifically, a key contribution of this dissertation is to show how domestic institutions affect both the relative profits of firms and the questions whether firms reinvest these profits or stash them on financial markets, thus, contributing to aggregate savings and capital exports. Before discussing this argument in more detail, the following section briefly outlines the relation between capital shares, corporate savings and the current account and discusses how a focus on these trends complements existing research on the sources of large current-account surpluses.

### 1.3.1 Falling Labor Shares, Rising Corporate Savings and the Current Account

In recent years, many advanced economies have witnessed a substantial decline in the proportion of national income that is paid out in wages and other forms of labor compensation. At the same time, corporate savings have increased. Whereas the relative share of profits in national incomes has gone up, firms, thus, largely refrained from reinvesting these profits or distributing them to shareholders and employees. Both of these trends have been discussed as major sources of rising income inequality, sluggish economic growth and heightened financial fragilities (Chen, Karabarbounis and Neiman, 2017; Karabarbounis and Neiman, 2012; Autor et al., 2017; Behringer and Treeck, 2018; Treeck, 2015). At the same time, they also constitute one of the most important drivers of the latest rise of global imbalances.

Figure 1.3 shows that declining labor shares and rising corporate savings have been associated with rising current-account surpluses. Both trends affect the balance-of-payments through a number of channels. First, declining labor shares imply lower labor costs. All else equal, countries with lower labor shares are likely to be more competitive on international markets and, thus, export more than countries with higher labor shares. As a consequence, falling labor shares have a negative effect on aggregate imports and a positive effect on the trade balance. Moreover, a rise in the share of corporate profits in national income also


FIGURE 1.3: Changes in aggregate labor shares and corporate savings and the current account changes in OECD countries. Labor shares are measured as the share of total labor compensation in gross value added in the corporate sector. Savings are defined as the excess of gross savings of all firms in an economy over their aggregated investment spending. Data is based on national accounts (Chen, Karabarbounis and Neiman, 2017).

affects domestic demand. According to the classical under-consumption argument, a fall in the share of wages or household earnings in national income reduces consumption because households have a higher marginal propensity to spend their income than firms and capital owners (Pettis, 2013; Behringer and Treeck, 2018). Accordingly, a number of studies have shown that, ceteris paribus, lower labor shares are associated with less imports and a decline in aggregate domestic demand (Treeck, 2015; Behringer and Treeck, 2018; Belabed, Theobald and Treeck, 2018).

In addition, the negative effect of rising profit shares on domestic demand, in recent years, was amplified by the fact that rising capital shares were not mirrored by larger corporate investment (Gruber and Kamin, 2016). Instead, firms in many advanced economies have started to retain large parts of their profits and stash them on financial markets, thus, contributing massively to aggregate savings and capital exports from many countries with large current-account surpluses (Karabarbounis and Neiman, 2012; Loeys et al., 2005; IMF, 2015). To illustrate the relation between corporate savings and the current account, Figure 1.4 displays the current-account position of Germany – the country which has currently the largest export overhang – by plotting the net borrowing and lending positions of the government, the household and the corporate sector. Whereas household savings remained

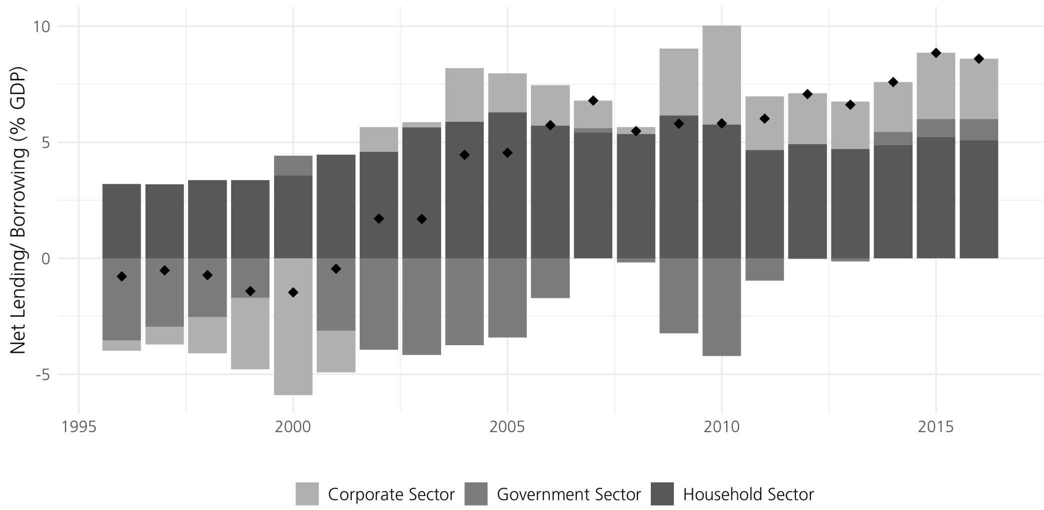


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FIGURE 1.4: The development of the net lending/ borrowing position of the household-, the corproate- and the government sector in Germany between 1995 and 2015. Markers illustrate the aggregate savings position of the German economy which corresponds to the current account. Data from OECD (2016).

quite stable over the last 20 years, the substantial rise in capital exports from Germany was largely driven by a reduction of the government deficit as well as the fact that the German corporate sector has turned into a net lender to the rest of the economy in the early 2000s and kept accumulating a rising pile of savings ever since. The German trajectory is representative of a larger set of countries. In many advanced economies, rising corporate savings were not absorbed by higher debts from government or households, and, thus, turned into a major source of capital exports and current-account surpluses (Gruber and Kamin, 2016; Karabarbounis and Neiman, 2012).

### 1.3.2 Existing Research

Fundamental changes in the wage setting and savings behavior of private firms, thus, constitute a main driver of the recent rise of current-account surpluses. Existing research on the political economy of global imbalances, however, focuses mainly on direct state interventions and the savings behavior of private households. It suffers from a blind spot when it comes to explaining important factors that structure much of today's global imbalances. A general focus on direct government interventions has led research on the drivers of current-account surpluses to concentrate largely on two possible strands of inquiry. One of the most prominent explanations focuses on the role of fiscal policies. Going back to the twin-deficit hypothesis first introduced by Volcker (1984), this literature looks at the state as a main driver of aggregate savings and total debts. Accordingly, large government deficits increase borrowing from abroad, lead to a rising inflow of foreign capital and produce current account deficits. Large budget surpluses, on the other hand, increase national savings and, thus, contribute to current-account surpluses (Chinn and Ito, 2008; Chen, Milesi-Ferretti and Tressel, 2012). Given that current-accounts, by definition, move in concordance with aggregated national savings, fiscal policies naturally play an important role in the emergence of imbalances. Nonetheless, the empirical evidence for government budgets being a main driver of current-account trajectories remains mixed (Chinn and Ito, 2007; Brissimis et al., 2013). Most importantly, however, the focus on government budgets overlooks the important role of the savings behavior of private firms for the current account in recent years.

A second way in which governments are said to influence current-account surpluses is by manipulating the competitiveness of their firms on international markets. An important line of research focuses on government interventions into exchange rate markets. From this perspective, imbalances are the result of national authorities' deliberate attempt to strengthen export competitiveness of domestic companies by hoarding foreign reserves and undervaluing their currencies real exchange rates (Dooley, Folkerts Landau and Garber, 2004; Adams and Park, 2009). Whereas historically such export-led growth strategies have been especially associated with Germany and Japan during the Bretton Woods system, more recently discussions about strategic current-account distortions have primarily focused on China and other East Asian countries with large surpluses (Serven and Nguyen, 2013; Vermeiren, 2014). Also focusing on state strategies to promote export competitiveness, scholars have argued that "neo-mercantilist" strategies pursued by core countries in Northern Europe were one of the root causes for the current-account imbalances in the Eurozone (Bibow, 2013; Cesaratto and Stirati, 2014). From this perspective, governments of countries like Germany or the Netherlands have made use of both labor market policies (Armingeon and Cranmer, 2015; Raess, 2014; Höpner and Lutter, 2018) as well as the general institutional set-up of their countries (Baccaro and Pontusson, 2016; Dustmann et al., 2014; Manger and Sattler, 2019) to push down wage costs and increase export competitiveness. As a result, exports increased, imports decreased and current-account surpluses rose. Again, these arguments point to important aspects of global and regional imbalances. However, the focus on government interventions not only overlooks the fact that the degree of export competitiveness largely depends on wage-setting dynamics that play out in private markets which remain predominantly shaped by the strategies of private actors. More importantly, accounts focusing on direct government interventions also fail to explain why increasingly competitive firms do not reinvest they rising profits in the domestic market and, thus, rebalance the current account.

A final prominent strand of research shifts the focus to private actors but mainly studies the savings behavior of households. The life-cycle hypothesis, for example, suggests that households smooth consumption over their lifetime by acquiring savings during their most productive years and use them during retirement. Thus countries with a high proportion of residents in their working age can be expected to exhibit higher saving rates while such with more elderly inhabitants are likely to run deficits (Thor and Zoega, 1999; Modiglian and Cao, 2004; Obstfeld and Rogoff, 2009; Chinn and Ito, 2007). Similarly, scholars focusing on financial market developments have stressed that rising current-account deficits in advanced economies, in recent years, largely stemmed from a combination of rising income inequality with the broad deregulation of credit provision, which seduced private household into accumulating large amounts of debts and spurred the inflow of foreign capital (Bayoumi, 1993; Diamond and Rajan, 2009; Kumhof et al., 2012; Ahlquist and Ansell, 2014). Countries in which domestic financial markets, for a number of reasons, remained less developed, on the other hand, incentivized citizens to build-up large amounts of private savings and, thus, produced capital exports and current-account surpluses (Caballero, Farhi and Gourinchas, 2008; Caballero, 2006; Chinn, Eichengreen and Ito, 2014; Höpner and Lutter, 2018; Braun and Deeg, 2019; Ahlquist and Ansell, 2014). Whereas this research has largely advanced our understanding of some of the main mechanisms underlying the political economy of current-account surpluses, their arguments are less helpful for explaining recent developments in surplus countries, in which household savings have remained quite constant and, instead, the rising savings of private companies have turned into the main driver of capital exports (Treeck, 2015; Belabed, Theobald and Treeck, 2018; IMF, 2018*a*). Summing up, existing research on the source of large current-account surpluses has provided important insights into the political economy of global imbalances. At the same, it suffers from a blind spot when it comes to explaining recent developments in the private sector, which have turned into one of the main drivers of rising export and saving surpluses in some advanced economies. This dissertation fills this gap by investigating the political institutional roots of falling wage shares and rising corporate savings.

### 1.3.3 The Emergence of Surpluses: Arguments, Findings and Main Contributions

What drives the fall of labor shares and the rise of corporate savings? In a highly stylized way, we can think of the emergence of large current-account surpluses and capital exports as a process involving two steps. First, a relative shift towards larger profit shares in total national income and second, a process in which surplus profits are increasingly banked up on international financial markets instead of being channeled back into the domestic economy. In the first two chapters of this dissertation, I argue that domestic labor market institutions crucially shape both of these trends through their impact on the preferences and relative power position of labor vis-a-vis capital. The next sections briefly summarize the main arguments and findings from these chapters.

#### Chapter 2: Wage Bargaining Coordination, Price Pressure and the Fall of Labor Shares

To understand why in some countries labor shares have fallen and profits have increased more strongly than in others, I argue, we need a better understanding of how global economic trends interact with domestic labor market institutions. Rising competitive pressure confronts workers with a trade-off between wage growth and job security. Domestic wage setting institutions and especially the level of wage bargaining coordination have a large influence on how employees resolve this trade-off. The more coordinated domestic wage bargaining systems are, the more employees will be willing to and capable of responding to heightened globalization pressure by curbing their wage demands. First, wage bargaining coordination increases employees' relative preferences for job security. Workers in countries with more coordinated wage bargaining systems are more likely to develop long-term relationships with their employers and invest in firm- and sector specific skills. This limits their outside options. When competitive pressures rise, employees in these systems are more likely to curb their wage claims in favor of securing their jobs. Second, coordination also increases workers capacity to successfully follow these preferences. Centralized wage bargaining enables employees to coordinate restraint within the firm and makes restraint more effective by providing the institutional preconditions for expanding it to the sectoral or even the cross-sectoral level. Against this background, I argue that rising competitive pressure will lead to more wage restraint and a larger rise of profit shares, the more coordinated wage bargaining systems are. While this allows less productive firms to stay in the market and, thus, reduces job losses, it comes at the expense of a substantial redistribution of income from labor to capital.

I test the empirical implications of this argument using panel data on firm-level labor shares of all publicly listed companies in 18 European countries between 1995 and 2015. To study the causal effect of rising competitive pressures on firm-level labor shares across different wage-setting systems, I rely on detailed information about yearly import tariff cuts on more than 5000 product lines negotiated by the European Commission in Preferential Trade Agreements (PTAs) with third countries. Since these tariff-cuts are unlikely to be affected by the labor-share trajectories in specific sectors, I can use this data to construct an instrumental variable testing the causal impact of rising competitive pressure across firms in different wage bargaining systems. The findings are largely in line with my argument. Rising trade competition leaves firm-level labor shares in decentralized systems largely unchanged but significantly decreases wage shares within firms in countries with more coordinated wage bargaining institutions. Moreover, I find that this decline is driven by decreasing wage growth rather than a reduction in the number of employees. The first chapter, thus, shows that institutions of economic coordination, which are often associated with more egalitarian economic outcomes (Rueda and Pontusson, 2000; Ahlquist and Answell, 2017; Hope and Martelli, 2019) can contribute to functional income inequality and play an important role for the rise of current-account surpluses when put under the strains of trade liberalization and structural economic change.

Chapter 3: The Decline of Profit Sharing Institutions and the Rise of Corporate Savings

Whereas falling labor shares are generally associated with rising current-account surpluses, their impact on capital exports is especially strong when firms refrain from reinvesting these rising profits in the domestic economy and instead save them on international financial markets. The third chapter argues that domestic labor-market institutions also affect the current-account through their impact on the rise of corporate savings. I argue that economic insecurity and the deregulation of financial markets have made it increasingly attractive for firm owners and managers to retain profits, stash them in financial assets and use them to realize short-term gains on financial markets. However, this strategy comes at considerable opportunity costs for workers. Given a surplus of profits, employees should either want their employers to use their idle revenues for higher wages or push them towards increasing their job security through investments into the productive capacities of the firm. An important insight of the third chapter is that the rise of corporate savings is subject to distributional conflicts between capital and labor. Their emergence, therefore, depends on political institutions that determine the balance-of-power between the two actors. The larger labor's political profit-sharing capacities are, the more they will pressure firms into using revenues for wage raises and investment. The more their in influence erodes, the larger the rise of savings and capital exports.

Empirically, I employ two strategies that provide broad evidence in line with this argument. First, I analyze panel data from 25 OECD countries over 19 years and show that there is a robust negative relation between corporate savings and different measures of the power resources of organized labor at the country level. Second, I move my analysis to the firm level and exploit a natural experiment provided by the German law on co-determination. The law mandates firms with more than 2000 domestic employees to occupy half of their supervisory boards with employee representatives, which renders workers with considerable power resources. Using the discontinuity around the mandated threshold, I am able to causally identify the effect of increased labor influence on corporate savings. I find that labor power in the form of co-determination significantly decreases savings. On average, firms with parity co-determination accumulate more than US$46 million (or about 4.3% of total assets) less in cash and short-term assets than similar companies without such institutions. Moreover, I also show that the decline of savings is accompanied by an increase of employee expenses and firm-level investments. Chapter 3, thus, shows that the demise of labor power played an important role in the rise of corporate savings and the increase of capital exports from some advanced economies.

Summing up, the first part of the dissertation argues that the emergence of large current-account surpluses largely depends on how domestic labor market institutions influence the ways in which firms and employees react to global economic shifts. First, the more coordinated domestic wage-setting institutions are, the more competitive pressures from globalization and technological change will result in wage restraint on the part of employees and a shift of national income from wages to profits. Second, the more this shift is accompanied by an erosion of domestic institutions that strengthen the bargaining power of workers vis-a-vis managers and large firm owners, the more likely it is that surplus profits end up as savings and financial investments on international markets. The first part of the dissertation, thus, shows that current-account surpluses are especially likely to occur in contexts in which the domestic institutional setup combines workers' incentives and capacities for wage restraint with a decline of their bargaining power.

## 1.4 The Persistence of Current-Account Surpluses

The first part of this dissertation studies the emergence of large current-account surpluses and especially focuses on how domestic labor-market institutions shape wages and savings in private firms. However, even if firms are responsible for a large share of the recent build-up of surpluses, this still bears the question, why governments have not counteracted it. In theory, political authorities could reduce surpluses through a number of policies, ranging from exchange revaluations or more public spending, to cuts in income and value-added taxes, wage policies or structural reforms that stipulate private investment. Nonetheless, only very few countries have made use of such measures. This of lack of adjustment is especially puzzling in times of severe balance-of-payments crises, in which surplus countries are often under intense international political pressure to re-balance. The second part of the dissertation, therefore, shifts the focus of the analysis from economic actors in private markets to deliberate political decisions and investigates the political factors that facilitate or impede surplus-country re-balancing in times of crises. It is based on a joint book manuscript with Stefanie Walter, Ari Ray and Raphael Reinke (Walter et al., 2019). As the lead author in both of these chapters I conducted the collection and analysis of all quantitative and qualitative data and, together with Stefanie Walter, developed the theoretical arguments. In addition to contributing to theory-building, Stefanie Walter was also involved writing the final drafts of both chapters. Ari Ray contributed by giving helpful comments on the chapters and providing language editing. The next section briefly reviews existing literature on the subject before turning to our main arguments and findings.

### 1.4.1 Existing Research

So far, research on the politics of current-account adjustment in surplus countries remains relatively scarce. Existing work has focused mainly on the question what makes surplus countries reluctant to adjust in times of crisis and is dominated by two possible explanations: the role of ideas and the importance of structural growth models. First, ideas-based explanations emphasize how strongly-held beliefs about the axiomatic merits of prudent fiscal policies and limited state involvement in the economy (Young, 2014; Bulmer, 2014; Wendler, 2014; Matthijs, 2016; Dullien and Guérot, 2012) and the causes of past crises (Aizenman, 2007; Mendoza, 2004; Chin, 2010; Howarth and Rommerskirchen, 2013; Haffert, Redeker and Rommel, 2019) influence policymaking by providing coherent narratives for why adjustment is not in the surplus country's interest or responsibility. For example, during the Eurozone crisis, surplus countries evoked orthodox economic ideas – often summarized under the header of ordoliberalalism – to argue that in order to address the Eurozone's problems, deficit states needed to reform their economies to regain competitiveness, whereas stimulating growth and inflation in surplus countries would only risk surplus-countries' hard-earned standing on international markets and endanger price-stability. This particular reading of the sources and cures for the crisis often seen as a major reason for the lack of current-account adjustment in countries like Germany or the Netherlands (Matthijs and Blyth, 2015; Dullien and Guérot, 2012; Schäfer, 2016; Ferrara et al., 2018). Similarly focusing on the role of ideas, research studying the reluctance of East Asian countries to re-balance their large trade surpluses in the 2000s has emphasized the belief that a repeat of the 1997 Asian Financial Crisis and the subsequent dependence on foreign institutional lenders must at all costs be avoided drove these countries to keep accumulating large savings and trade surpluses (Aizenman, 2007; Mendoza, 2004; Chin, 2010; Dooley, Folkerts Landau and Garber, 2004).

A second explanation emphasizes the importance of growth models and focuses on the structural importance of the export sector for surplus country economies. Going back to studies on the persistence of current-account surpluses in Germany and Japan under Bretton Woods, scholars have pointed to the structural importance of the export industry in many surplus countries as a major impediment for the adjustment of current-account surpluses (Kreile, 1977; Kinderman, 2008). In the context of emerging economies with current account surpluses, studies in this vein emphasize that persistent current-account surpluses reflect export-oriented growth strategies (Prasad, 2011; Chinn, Eichengreen and Ito, 2014; Dooley, Folkerts-Landau and Garber, 2009), whereas recent research on the lack of adjustment amongst surplus countries in the developed world mainly builds on the literature on comparative capitalisms (Hall and Soskice, 2001; Baccaro and Pontusson, 2016). What unites these approaches is the idea that the structural need to preserve export competitiveness in surplus countries creates a broad coalition of policymakers, employers and workers, all of whom are opposed to measures that would lead to internal adjustment (Iversen and Soskice, 2018; Hall, 2012; Höpner and Lutter, 2018; Leupold, 2015).

Existing work provides valuable insights into surplus country resistance to adjustment, but they also leave open some question marks. For one, the two dominant explanations paint a picture of surplus countries as being united in their resistance towards macroeconomic adjustment, either because of the dominance of ideas and economic narratives that frame adjustment as irresponsible and harmful or because safeguarding the export-led growth model constitutes the national interest. Yet adjustment policies in surplus countries also generate significant domestic distributive conflicts (Frieden and Walter, 2017), analogous to the distributive struggles that characterize balance of payments adjustment in deficit countries (Eichengreen, 1992; Simmons, 1997; Walter, 2013). Decisions whether to engage in re-balancing by boosting domestic demand, for example, through cutting taxes or stipulating wage growth or to do nothing at all will hurt some domestic actors and benefit others. The question who wins and who loses from (non-) adjustment and how these distributional impactions influence politics is, thus, crucial for understanding the political economy of persistent surpluses. Second, existing approaches concentrate predominantly on fiscal and monetary policy as well as wage-setting issues. In contrast, we emphasize that macroeconomic adjustment decisions are, multi-dimensional. Surplus country resistance to adjustment has significant consequences abroad, which puts global and regional financial stability in question and increases the financing needs of those countries running large current account deficits, especially when private capital inflows into these countries dry up. Understanding why surplus countries opt against adjusting internally, thus requires a more multidimensional understanding of how surplus country decision-makers evaluate these alternatives relative to the option of adjusting domestic policies in a way that reduces the current account surplus.

### 1.4.2 The Persistence of Surpluses: Argument, Findings and Main Contributions

We complement existing research by analyzing how domestic politics impede or facilitate current-account adjustment in surplus countries in times of crisis. To study these processes, chapters 4 and 5 focus on surplus countries in the Eurozone crisis. During this crisis, external pressure for countries such as Germany or the Netherlands to re-balance their large export overhangs was extraordinarily high. On the one hand, their macroeconomic position was heavily criticized by international institutions (European-Commission, 2014; IMF, 2016*a*) and partner countries (FT, 2010; The Economist, 2016*b*). On the other hand, all Eurozone members were adamant in their wish to safeguard the monetary union, which effectively ruled out the option of major exchange rate realignments between members of the Eurozone. Moreover, the crisis unfolded in the highly institutionalized context of the European Economic and Monetary Union (EMU), which could have facilitated a coordinated crisis response. In many ways, the Eurozone crisis, thus, provides us with a most-likely case for economic adjustment in surplus countries. By disentangling the factors that kept surplus countries from re-balancing in this politically and economically highly interdependent context, we hope to draw conclusions about the distributional conflicts that shape the politics of non-adjustment in surplus countries more generally. Put simply, we argue that these politics are shaped by distributional conflicts between important economic interest groups and the way in which these distributional conflicts interact with the preference and priorities of the broader public and the economic convictions of policymakers. The following section gives a brief overview of the relevant context of our argument in the joint book manuscript before summarizing our most important arguments and findings for surplus countries.

#### Adjustment Strategies and Trade-Offs in Balance-of-Payment Crises

Building on the overall framework of our joint book manuscript (Walter et al., 2019), we argue that domestic interest groups base their preferences with regards to re-balancing the current account on the trade-offs they make between three possible crisis responses: external adjustment, internal adjustment and financing. External adjustment implies re-balancing through an exchange-rate appreciation, which makes exports more expensive, stimulates imports, and, reduces the trade surplus. As in deficit countries, the costs of external adjustment increase with the rigidity of the exchange-rate regime. External adjustment is costlier

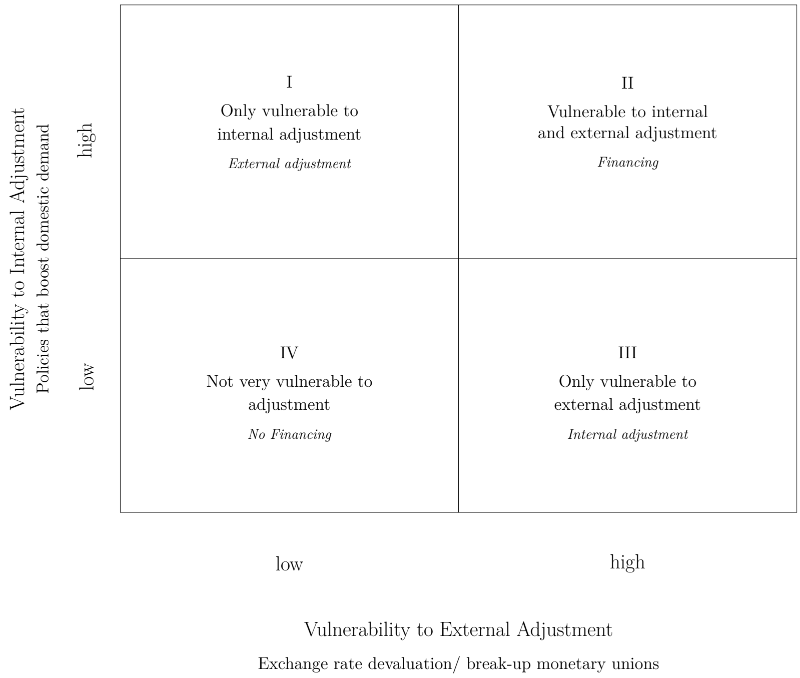


FIGURE 1.5: Vulnerability Profiles and Preferred Policy Responses

in countries with pegged rather than flexible exchange rate regimes and in a monetary union, it implies a (at least a partial) break-up of the union. As a second option, surplus countries can also re-balance their current-accounts internally by providing incentives for market actors to save less and invest and consume more. Finally, surplus countries can contribute to solving balance-of-payment pressures by providing deficit states with the financial means to sustain their deficits. In this case, they refrain from adjusting their own current-accounts and instead engage in financing through direct transfers such as bailouts or debt reliefs or through institutionalized and permanent forms of transfers.

We argue that the preferences of important economic interest groups with regards to the management of balance-of-payment crises are informed by their "vulnerability profiles" (Walter, 2013, 2016). i.e. the trade-offs they make between the net costs of external, internal adjustment and financing. Figure 1.5 depicts a stylized overview of ideal-type vulnerability profiles, which interest groups may exhibit as well as the preferred policy response associated with each of these profiles. A first type (quadrant I) is vulnerable to internal adjustment, but not to a revaluation of the exchange rate. Because financing is costly as well this first type is likely to prefer external adjustment to any other form of crisis management. A second type (quadrant III) would gain from a boom in domestic demand but would lose from an exchange-rate appreciation. Because internal adjustment creates net benefits for this group while financing is costly, interest groups of this type will favor internal adjustment over external adjustment or financing. Finally, a third type (quadrant II) is vulnerable to internal as well as external adjustment. In general, we expect this type of actors to be most willing to provide deficit countries with some form of financing.

Based on this framework, the second part of this dissertation makes two main contributions. First, it systematically theorizes and tests how distributional conflicts between well-organized interest groups make internal adjustment a politically difficult road to pursue. Second, it investigates how these distributional conflicts amongst organized interests interact with the preferences and priorities of the broader public in shaping actual adjustment outcomes in times of balance-of-payment crises.

Chapter 4: Distributive conflict and interest group preferences in surplus countries

Chapter 4 starts investigating the politics of (non-) adjustment in surplus countries by focusing on the preferences of organized economic interest groups. Whereas many existing theories assume that such groups have an important influence on questions concerning internal adjustment, external adjustment and financing (e.g. Iversen and Soskice, 2018; Thompson, 2015; Steinberg and Vermeiren, 2015), we still lack systematic evidence on the preferences and strategies of these groups during severe balance-of-payment crises. We argue that surplus countries' resistance to internal adjustment is rooted in domestic distributive struggles about the design of possible adjustment policies amongst important economic groups. Internal adjustment is contentious, because it can be implemented in very different ways, many of which benefit some groups, but also hurt others. As a result, vulnerabilities towards internal adjustment are highly policy-specific and even in situations in which there is general support for strengthening domestic demand, important economic interest groups disagree about how to achieve this goal. The resulting polarization in interests about how to adjust internally, makes domestic re-balancing politically costly. In situations in which a broad interest group consensus exists that external adjustment is to be avoided, this leaves financing as the most attractive option for organized economic interests.

We examine this argument using original survey data from more than 350 economic interest groups from Germany, Austria and the Netherlands. This survey constitutes the first systematic empirical investigation into preferences that politically important interest groups held with regards to the management of the Eurozone crisis. We complement this survey data with 30 qualitative interviews with policy-makers and interest-group representatives from the three countries. Our results show that, contrary to much existing work, general support for expansionary economic policies among interest groups in all the three countries was surprisingly high. An overwhelming majority of about 70% of all groups in the three countries actually preferred some form of internal adjustment over alternative crisis responses. However, domestic actors disagreed about which specific policies should be implemented to achieve this goal. Different types of interest groups, such as employer associations, trade unions, or social policy groups varied significantly in their support for and opposition to specific possible internal adjustment policies and we find that this variation is clearly associated with objective material factors such as how trade dependent groups are or to what degree their members would benefit from a boost in domestic demand. Whereas a large majority of interest groups, thus, supported internal adjustment in the form of policies that were to their advantage, support dropped significantly when internal adjustment involved policies which would hurt them. At the same time, support for financing increased in these situations. Because financing was also a less salient issue for interest groups and because there was widespread determination to avoid a break-up of the Eurozone (though some variants, such as a Greek exit, were viewed as less detrimental), this polarization turned conditionality-based financing into the politically most attractive strategy for organized interests. The persistent surplus country resistance against internal adjustment, thus, seems rooted, at least partly, in distributive struggles about the design of possible adjustment policies among interest groups.

Chapter 5: Crisis Politics in Surplus Countries

Finally, Chapter 5 puts the distributional conflicts amongst interest groups into the broader context of crisis politics in surplus countries and investigates how they interacted with the preferences and priorities of voters and domestic political elites in shaping crisis outcomes. Most importantly it investigates the question why – even though interest group conflicts about internal adjustment policies looked very similar in all the three countries we study – surplus countries in the Eurozone still varied in the extent to which they engaged in domestic expansion during the crisis. Whereas Germany, for example, took only very limited steps to boost domestic demand during the crisis, Austria engaged in a multitude of expansionary policies in the same period. Leveraging public opinion data, qualitative evidence and information gathered in 30 interviews with policymakers and group representative, we employ a comparative case study of crisis politics in Germany, Austria and the Netherlands.

We show that the gridlock amongst interest groups about how to adjust internally is especially likely to result in non-adjustment in contexts in which voters give little priority to boosting domestic demand. In contrast to the notion that expansionary policies in surplus countries are hampered by fiscally austere voters with a strong preferences for limited government expenditure (Howarth and Rommerskirchen, 2013, 2017), our broad survey of public opinion data shows that a majority of voters actually would have been open to increased spending during the crisis years. However, whether this general support gains political traction depends on the domestic economic context. If the domestic economic climate is good, the salience of economic reforms for voters is low and adjustment politics are likely to be dominated by "quiet politics" (Culpepper, 2011). In this context, potential re-balancing measures are debated primarily amongst economic experts, affected organized interests and political elites and distributional conflicts between interest-groups have a high potential of blocking economic reforms that could contribute to internal adjustment. If the domestic economic situation is bad, as it was the case in Austria during the Eurozone crisis, this general support for public spending amongst large parts of the electorate becomes a salient issue for voters. In this context, policymakers have large incentives to overrule the gridlock amongst interest groups and implement measures that boost domestic demand and lead to a re-balancing of the current account. Chapters 5, thus, shows that politics of adjustment in surplus countries are characterized by a paradox: the better a country's economy is doing, and hence the easier it is economically to pursue broad adjustment measures, the less likely such voter pressure is to occur and the more likely it becomes that the distributional conflicts among interest groups result in nonadjustment.

### 1.5 Summary and Implications

Summing up, this dissertation adds a number of important insights to our knowledge of the political economy of global imbalances. First, it puts the emergence and persistence of large current-account surpluses front and center. Since much of the existing literature focuses on countries with current-account deficits, this constitutes a significant step towards a more holistic understanding of the root causes of sustained global imbalances. Second, it shows that the emergence of such surpluses is part of much broader economic trends towards falling labor shares and rising corporate savings. These trends have crucial distributional implications and are largely shaped by domestic labor-market institutions. This dissertation shows that fall of labor shares has been especially pronounced in contexts, in which high levels of wage bargaining coordination foster employees' incentives to respond to the competitive pressures of globalization and structural change by curbing their wage claims. The rise of corporate savings, on the other hand, was largely driven by a demise of domestic institutions that strengthen the bargaining power of labor. These findings also shed new light on why surpluses are increasingly concentrated in the developed world, as many advanced economies such as Germany or the Netherlands combine constantly high levels of wage bargaining coordination with a secular decline in workers' bargaining power (Thelen, 2012; Höpner and Lutter, 2018; Hassel, 2014). The rise of surpluses is, thus, neither the outcome of direct state action nor a result of pure market forces. Instead it is driven by the ways in which global economic trends interact with political labor-market institutions in shaping the behavior of private firms. Finally, this dissertation also shows that not just the emergence but also the persistence of large current-account surpluses is heavily shaped by distributional conflicts. Much of the resistance against re-balancing the current-account is rooted in distributional conflicts about the specific design of internal adjustment policies amongst organized economic interest groups. However, this dissertation also shows that whether these conflicts result in nonadjustment or not depends on whether policymakers face electoral incentives to overrule these conflicts and force interest groups into compromises. Paradoxically, this makes current-account adjustment in surplus countries especially likely to occur in economically bad times, in which domestic expansion becomes a salient issue in national political debates. A core finding of this dissertation is, thus, that the persistence of current-account surpluses is less structural than often assumed. Whether surplus countries re-balance or not is, at its heart, a political issue.

### 1.5.1 Implications for Research in Political Economy

The findings presented in the following four chapters have a number of implications for research in political economy. First, my findings on the institutional drivers of falling wage shares show that we need a better understanding on the potentially negative side effects of the kinds of labor-market institutions, that we often associate with more egalitarian economic outcomes (Thelen, 2012). A long tradition of research in international and comparative political economy has shown that centralized wage bargaining and other economic institutions that characterize coordinated market economies can lead to higher growth (e.g. Calmfors and Driffill, 1988; Driffill, 2006) and less income inequality (e.g. Rueda and Pontusson, 2000; Pontusson, Rueda and Way, 2002). More recently, scholars have argued that these institutions also mitigate the income-inequality inducing effects of technological change (Hope and Martelli, 2019) and trade liberalization (Baccini et al., 2018). These positive effects should by no means be understated. However, my findings show that, to a certain degree, they are achieved at the expense of rising functional income inequality and an increased concentration of wealth on the side of capital. Whether, normatively, this is the more desirable outcome, is up for debate. In any case, scholars need to pay close attention to these potential side-effects and the trade-offs between functional and regular income inequality to arrive at a more complete understanding about the ways in which labor-market institutions structure the distribution of economic resources in advanced economies.

Second, my findings show that research in political economy needs to expand its investigation into the long-term effects of declining trade unionism and labor power. A large literature within comparative and international political economy has analyzed how the decline of trade unions affects inequality (Ahlquist and Answell, 2017; Scheve and Stasavage, 2009), partisan politics (e.g. Becher, Stegmueller and Käppner, 2018; Mosimann and Pontusson, 2017; Rosenfeld, 2014) as well as trade and regulatory politics (Dean, 2015; Mosley and Singer, 2015). Building on these insights, this dissertation shows that the erosion of trade unionism and the profit-sharing capacities of labor more generally also affects the rise of corporate savings and, thus, the very fundamental question whether profits are reinvested and used in ways that stipulate growth and employment. These findings make it plausible that the secular decline in the bargaining power of labor has implications for other important macroeconomic trends as well. For example, the results of chapter 3 suggest that the erosion of labor power may also play an important role for secular stagnation (Summers, 2015; Acemoglu and Restrepo, 2017; Gordon, 2015) and decreasing productivity growth (Goodridge, Haskel and Wallis, 2018; Soskice and Carlin, 2018). By investigating the broader implications of declining labor power, future research, thus, stands to gain a much broader understanding of some of the structural changes currently shaping the functioning of advanced capitalism.

As a third major implication for future research, this dissertation shows that research in political economy needs a better understanding of the joint macroeconomic effects of the decline and resilience of formerly complementary labor-market institutions. One reading of the findings of the first two chapters is that large current-account surpluses emerge in contexts in which stable wage-bargaining coordination is combined with declining trade union power. For a long time, these two institutions could be seen as largely complementary. Coordinated wage bargaining systems allowed centralized trade unions to moderate their wage demands and, thus, ensure sustained profitability and job security. In turn, powerful trade unions were able to pressure firms into using surpluses revenues for productive investment, thus, stabilizing future growth and employment. A possible interpretation of my findings is that one aspect of this system - coordinated wage bargaining systems - has proven to be remarkably resilient to structural change, while trade union power has constantly declined. As a result, employees in coordinated institutional can still engage in wage moderation to safeguard future employment. However, they are increasingly incapable of making sure that the fruits of wage moderation are spent in ways that benefit their interests. Research in comparative political economy has recently started to investigate how incremental changes in domestic institutional environments influence outcomes in domestic labor markets and the welfare state (Thelen, 2012, 2009). This dissertation shows that research in international and comparative political economy should also investigate in more detail how piecemeal changes in formerly coherent domestic economic institutional systems affects macroeconomic outcomes and imbalances.

The results of this dissertation also have implications for the research on the ways in which organized interests influence politics. For one, our findings on the role of interest groups in the Eurozone crisis show that we need a better empirical understanding of the preferences and priorities of organized interest groups. Much research on the role of societal interests in economic policymaking relies on strong assumptions about the preferences of different interest groups, but often uses only broad proxies to operationalize these preferences and seldom studies them in a systematic empirical way (Meyer, 2007; Baccaro and Pontusson, 2016; Hall, 2015; Iversen and Soskice, 2018). However, the findings of our survey show that interest groups, which often represent a diverse membership, have to navigate complex issues and make difficult trade-offs are likely to arrive at positions that are difficult to predict on purely theoretical grounds. As is evident from the broad support for specific forms of internal adjustment, even amongst export-oriented interest groups in surplus countries, this is especially true for complex macroeconomic issues. Even the preferences of large and well-organized umbrella organizations are often characterized by a very micro-economic oriented perspective, a finding that should be especially relevant for the emerging literature on the societal underpinnings of structural economic growth models (Baccaro and Pontusson, 2016). Future research should, thus, invest more in studying the preferences of relevant economic groups empirically. By publishing our survey data, we hope to support first steps into this direction.

Finally, our case studies on Eurozone crisis politics in surplus countries point out that research in political economy needs to investigate more closely, how the preferences of organized interests interact with those of voters and the priorities and ideas of the political elite in shaping political outcomes. Often the influence of interest groups, the pressure of the electorate and the ideological orientation of political decision makers are still treated as competing explanation for important political outcomes (e.g. Hacker and Pierson, 2010; Blyth, 2013; Matthijs, 2016; Thompson, 2015; Hall, 2012; Schneider and Slantchev, 2017). While focusing on one ontological perspective ensures a certain theoretical crispness, there is a lot to be learned from combining these different schools of thought and asking what matters when instead of what matters most. Recent research has taken promising first steps into mapping the scope conditions of each perspective in greater detail (Culpepper, 2011; Bell and Hindmoor, 2013; Reinke, 2014; Busemeyer, Garritzmann and Erik Neimanns, 2019). Our findings contribute to this nascent literature, for example, by showing that the general economic climate matters a great deal for whether the politics surrounding economic reforms are dominated by interest group politics or voter preferences and electoral concerns. While our research focuses on debates about internal adjustment during sever balance-of-payment crises, this pattern is likely to hold for a multitude of economic reforms, ranging from the regulation of labor and product markets to fiscal policies and taxation. Investigating these processes provides a fruitful avenue for future research on the politics of economic reforms.

### 1.5.2 Implications for Policy Making

Finally, the four chapters of this dissertation have implications for three different policy areas. Chapter 2 speaks to current debates about tackling rising functional income inequality in advanced economies. Based on the findings of a number of studies from the US context (Loecker, Eeckhout and Unger, 2018; Autor et al., 2017; Elsby, Hobijn and Sahin, 2013), this debate so far focuses mainly on the rise of superstar firms. In the US, these highly competitive and capital intensive companies make lots of profit per employee and since they are becoming a bigger and bigger part of the economy, the overall share of GDP going to labor goes down. Policy debates about tackling rising functional income inequality in the US, therefore, often center on tools to limit the market power of such firms, for example, through antitrust reforms and stipulating productivity growth in smaller less superstar-like companies. This dissertation suggests that it would be a mistake for policymakers in more coordinated market economies to take too many cues from this debate. As chapter 2 shows, in countries with wage bargaining coordination, the decline of labor shares is not primarily driven by rising superstar companies but by encompassing wage restraint within existing firms. This warrants different solutions. One possibility would be to extent employee ownership. If a growing share of revenues goes to capital, one way of reducing inequality is to expand capital ownership amongst workers. Governments could, for example, give tax incentives to firms with employee stock purchase plans. Companies could also be required to transfer a percentage of their shares to a fund controlled by employees, which pays regular dividends to workers. Other measures might include state managed wealth funds which hold shares of a broad part of domestic firms. If such measures prove to be insufficient, a more redistributive approach to the taxation of profits could also be a way of providing employees with a greater share in the wealth they create.

A second important policy area, this dissertation speaks to is the question of how to bring affluent companies to invest their profits. Given the fact that the rise of corporate savings goes hand in hand with lower investments and decreasing productivity growth, this question has become a pressing issue for policymakers in many advanced economies and especially countries with large current-account surpluses (IMF, 2018*b*, 2013; Soskice and Carlin, 2018; Acemoglu and Restrepo, 2017). A direct policy implication of the findings presented in chapter 3 is that expanding the profit-sharing capacities of labor could be one way of achieving this. As larger bargaining power of labor decreases savings and stipulates investment, policymakers who are interested in stimulating private investment could consider implementing policies that give employees a greater say in negotiations over the usage of profits. Parity codetermination in supervisory boards – which I use for the regression discontinuity design in chapter 3 – seems to be provide one useful tool of doing so. However, this is just one possible institutional set-up and there is a multitude of ways in which strengthening the role of labor in corporate governance could be achieved. For example, U.S. Senator Elizabeth Warren has recently suggested a broad reform of corporate governance, which would, amongst other things, require federally chartered companies in the US to let workers elect 40% of their board member.[1] Similarly, Theresa May had pledged to allow workers greater representation in company boards during her campaign to be Prime Minister in the UK in 2016 and French President Emmanuel Macron has made related promises in the context of the debates about his labor market reforms in 2018 (Garnero, 2018). My findings suggest that these and similar reforms which effectively increase labor power at the firm level could decrease savings, stipulate private investment and, thus, have positive effect on long-term growth and productivity.

Lastly, this dissertation also has important implications for political debates about the persistence of global imbalances and, especially, the long-rung prospect of macroeconomic stability in the Eurozone. In contrast to arguments which see the lack of adjustment in countries with large current-account surpluses as a structural feature of their economies, the findings of chapter 4 and 5 show that non-adjustment it is largely rooted in politics. Distributional conflicts about how to adjust are at the heart of much of the resistance against expanding domestic demand and investment in export-oriented economies. This opens the scope for possible political compromises. For the imbalances within in the Eurozone this is good news. Many scholars and pundits have argued that the economic structures of the members of Eurozone are simply too diverse and tying them to one single currency will always result on lasting imbalances and reoccurring crises (Höpner and Lutter, 2014; Streeck,

[1] See for example (Klein, 2018) and https://www.theguardian.com/commentisfree/2019/jun/03/bernie-sanders-workers-economy-employees-inequality-corporate-power

2015; Mody, 2018). In contrast, this dissertation shows that countries like Germany or the Netherlands are by no means destined to run surpluses of the current scale. In fact, as growth prospects in some core countries of the Eurozone are darkening, a good argument can be made that domestic expansion is soon to become a salient issue for some of the most export-oriented countries in Europe. The German government, for example, has recently discussed to increase its budget deficit to boost domestic demand in case of a recession.[2]. In some sense, my findings, thus, suggest that current-account surpluses within in the Eurozone are likely to decrease in the near future. However, for a more lasting approach to reducing global as well as European imbalances from the surplus side, decision makers, of course, should also try to repair the roof when the sun is still shining. This dissertation shows that current-account adjustment in surplus countries is politically much more difficult to achieve in a good economic times. To make it easier, policymakers should focus on seeking domestic coalitions and building adjustment packages that make spurring demand attractive for a diverse set of economic interest groups. At the same time, actors who are interested in reducing imbalances should aim at turning aspects of strengthening domestic demand and rebalancing the current account into publicly salient issues, for example through politicizing a lack of public spending, low wage growth or limited private investment. Even doing so, reducing current-account surpluses will remain politically challenging. However, on the good side this dissertation shows that there is little to suggest that it is structurally impossible.

[2] See https://www.spiegel.de/wirtschaft/soziales/bundesregierung-will-bei-rezession/schwarze-null-opfern-a-1282210.html

# Chapter 2

# The Politics of Waiving Wages

## Trade, Labor Market Institutions and the Decline of Labor[1] Shares

**Abstract**

The fall of labor's share of GDP in many advanced economies is increasingly gaining attention as a key driver of economic inequality and macroeconomic imbalances. While there is a growing literature on the causes of this trend, we still know little about what drives variation in wage share developments across countries. I argue that domestic institutions play an important role. The more coordinated domestic wage bargaining institutions are, the larger the incentives and capabilities of employees to respond to mounting price pressure by curbing their wage demands. As a result, rising competitive pressure leads to a more rapid decline of labor shares in countries with more coordinated wage bargaining instutions than in countries with more decentralized modes of wage setting. I find robust evidence in line with this argument using microlevel data on publicly listed firms in the European Union and exploiting exogenous variation in trade liberalization. These findings have important implications for our understanding of the political economy of falling labor shares as well as the way in which domestic institutions mitigate globalization pressures.

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[1] Test

## 2.1 Introduction

For David Ricardo, determining the laws that regulate the distribution of income between "the proprietor of the land, the owner of the stock or capital necessary for its cultivation, and the labourers by whose industry it is cultivated [was] *the* principal problem in Political Economy" (Ricardo, 1821, p.1). For a long time, scholars that followed in his footsteps were less fascinated by the functional distribution of income, mainly because factor shares - that is the slice of national income that goes to capital (capital share) or is paid out in wages and other forms of labor compensation (wage share) - seemed to change so little over time that their stability became one of the fundamental features of most macroeconomic models (Kaldor, 1957; Mankiw, 2007). However, in recent years, interest in distribution of income between capital and labor has made a striking comeback into research and international headlines.

This has several reasons. First, after decades of stability, labor's share in national income has fallen substantially in the last 30 years (Chen, Karabarbounis and Neiman, 2017; Autor et al., 2017; Stockhammer, 2015). A decreasing share of the total income in advanced economies is, thus, paid out in wages and other forms of labor compensation and a growing slice goes to the owners of capital.[2] Compared to the 1980s, average national wage shares in OECD countries have dropped by almost 10 percentage points, reaching their lowest level just prior to the global financial crisis and not recovering materially ever since (see Figure 2.1). Second, this trend is not only at odds with conventional economic wisdom, it is also linked to a range of important political and economic issues. For one, declining wage shares imply rising income inequality (Dao et al., 2017). As most capital is owned by individuals at the top of the income distribution, an increase in the share of national income that goes to capital automatically widens the gap between high income earners and poorer workers (Atkinson, 2009; Adams and Neiman, 2014; Piketty, 2014). Moreover, research shows that within the work force, the brunt of the declining wage shares was borne by low- and medium-skilled workers (Dao et al., 2017; Autor, Levy and Murnane, 2003; Dauth et al., 2017). According

[2]The aggregate labor share equals total compensation of labor across all three sectors divided by GDP. Since this paper is mostly interested in trends in the private sector, I follow Chen, Karabarbounis and Neiman (2017) and use the labor share in the corporate sector to describe trends at the macro level. This corporate sector wage share equals the sum of compensation paid to labor, divided by the gross value added (GVA) in the corporate sector.

to some pundits, these two factors turn declining wage shares into the single most important driver of rising economic inequality in countries like the US (Mishel, 2012).

Besides adding to income inequality, falling wage shares have also been associated with macroeconomic instability. On the one hand, rising functional income inequality can impede growth. As wage growth remains a key driver of domestic demand, the fact that an increasingly large share of revenues go to profits has been associated with much broader debates about low growth and secular stagnation (Gonzalez and Mathy, 2018; Storm and Storm, 2018; Summers, 2015). On the other hand, falling wage shares also are a key factor in the emergence of global current-account imbalances. While being a worldwide trend, the fall of labor shares has been especially pronounced in export-oriented countries such as Germany, Japan or the Netherlands (**?**Behringer and Treeck, 2018). Since rising profits have not been mirrored by corresponding increases in private investment, declining wage shares directly fueled excess savings and capital exports from these countries (Treeck, 2015; Redeker, 2019) and thus contributed to current-account instabilities.

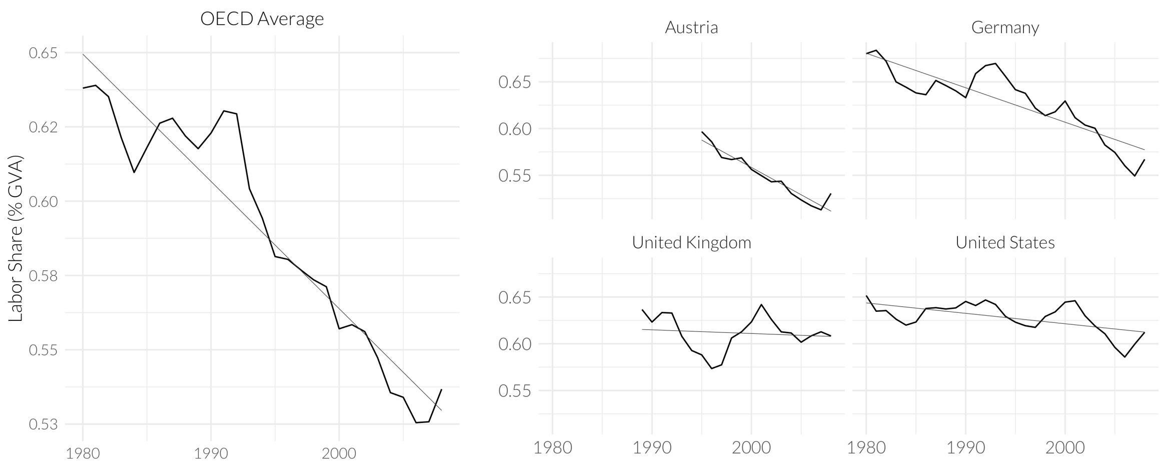


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FIGURE 2.1: The development of labor shares in OECD countries. Labor shares are measured as the share of total labor compensation in gross value added in the corporate sector. Data is based on national accounts (Chen, Karabarbounis and Neiman, 2017).

Existing research mainly proposes three mutually reinforcing explanations for the global decline of wage shares. A first strand focuses on the demise of labor power. From this perspective, factor shares are the result of distributional conflicts between capital and labor with each side bargaining to maximize their slice of national income (Kristal, 2013). The more the bargaining power of workers and employees relative to capital decreases, the more wage shares fall (Ahlquist and Answell, 2017). In recent years, labor shares, thus, decreased as multiple factors, ranging from structural economic change and globalization(Kristal, 2013; Elsby, Hobijn and Sahin, 2013) to the political deregulation of labor markets (Blanchard and Giavazzi, 2003; Bental and Demougin, 2010; Thelen, 2014) and the demise of trade unions (Kristal, 2010; Dünhaupt, 2013), all weakened workers' bargaining position.

A second line of research emphasizes the role of technological change. Karabarbounis and Neiman (2012), argue that starting from the 1980s, technological advances began to significantly decrease the costs of investment goods relative to labor. Given these changing input prices, firms across the world increased their capital to labor ratios, which according to their estimates accounts for about half of the decline in the labor's share of global income. Other studies have confirmed that labor-displacing technological change explains a substantial fraction of declining wage shares (Autor and Salomons, 2018).

Finally, market concentration has become an influential explanation for declining wage shares. Focusing on the US, Autor et al. (2017) develop a model in which rising price competition due to globalization or technological advantages benefits only the most productive firms in each sector. As a consequence, product market concentration rises and industries become increasingly dominated by very productive firms with high profits and low labor shares (see also Loecker, Eeckhout and Unger, 2018)

While the existing literature has greatly advanced our understanding of the drivers of globally falling wage shares, they fail to explain an important pattern across countries. In recent years, the fall of wages in national income was most pronounced in export-oriented coordinated market economies (**?**Behringer and Treeck, 2018). Figure 2.1 compares the development of private sector wage shares between the US and the UK as two classical examples of liberal economies that have witnessed rising levels of economic inequality with the trajectories of labor shares in the economically more coordinated Germany and Austria, which are often associated with more egalitarian economic outcomes (Thelen, 2012). Labor shares fell by about 5 and 2.5 percentage points in the US and the UK since the beginning of the 1990s. While this constitutes a substantial decline, the trend is far flatter than in Germany or Austria, where wage shares fell by almost twice as much. This difference is especially surprising as it does not seem to square with existing theories. Both Germany and Austria still have relatively strongly organized trade unions and comparably regulated labor markets

(Thelen, 2012; Hall, 2012). At the same time, technological change and globalization should lead to similar increases in price competition across advanced economies (Autor et al., 2017) and Baccini et al. (2018) show that trade shocks have affected product market concentration in coordinated market economies such as Germany or Austria much less than in the US or the UK. So how can we make sense of the cross-country pattern in declining wage shares?

To understand these differences, I argue, we need a better understanding of how global economic trends interact with domestic labor market institutions. Rising competitive pressure confronts workers with a trade-off between wage growth and job security. Building on insights from the classical comparative capitalisms literature (Calmfors and Driffill, 1988; Hall and Soskice, 2001; Manger and Sattler, 2019; Baccaro and Pontusson, 2016) and recent research on the roots of economic divergence in the Eurozone (Hancké, 2013; Hall, 2012; Höpner and Lutter, 2014; Streeck and Elsässer, 2015), I argue that domestic wage setting institutions have a large influence on how employees resolve this trade-off. If wage bargaining is decentralized, workers have little incentives and capacities to choose employment security over wage growth. As a result wages are downward sticky and aggregate labor shares fall only due to a reallocation of economic activity from less to more capital intensive firms. However, the more coordinated domestic wage bargaining systems are, the more employees will be willing to and capable of responding to heightened globalization pressure by curbing their wage demands. As a result, wage bargaining coordination allows less productive firms to remain in the market and reduces the "winner-takes-most" dynamics of rising competitive pressure (Baccini et al., 2018). However, this strategy comes at the expense of a significant redistribution of income from labor to capital.

I test this argument in two steps. First, I use panel data from publicly listed firms in all member countries of the European Union to analyze how much firm-level labor shares have declined across different countries. More importantly, I analyze to what degree labor share trends were dominated by changes *between* (as much of the existing literature suggests) or *within* firms. Using classical decomposition tools, I show that labor shares not only have fallen more strongly in more coordinated wage bargaining systems but that these changes are also driven by dynamics *within* rather than *between* firms. In a second step, I combine the firm level data with information on European level trade exposure to analyze how labor shares react to trade liberalization. Using measures of de jure tariff cuts and instrumented import growth based on European preferential trade agreements (PTA), I show that trade competition significantly decreases labor shares within firms in countries with more coordinated wage bargaining institutions and that this decline is driven by decreasing wage growth rather than a reduction in the number of employees.

My findings add to existing research in a number of ways. First, they contribute to our understanding of the political economic processes that underlie falling wage shares across different institutional contexts. On the one hand, showing that the decline of labor shares in countries with more coordinated wage bargaining systems is the result of wage restraint rather than market concentration adds important nuances to the debate about the potential causes of falling labor shares. It also shows that it is often problematic to generalize from studies that focus predominantly on the US. On the other hand, getting this diagnosis right is important to address the problem of falling wage shares correctly in different contexts. In other words, what helps to tackle functional income inequality in the US might fail to work in Germany. Second, this study contributes to a rich literature on how national labor market institutions change in response to the pressures of globalization (e.g. Hall and Soskice, 2001; Thelen, 2009, 2012; Hassel, 2014; Malesky and Mosley, 2018). Much of this literature has centered on the question whether national differences in labor market institutions converge (Streeck, 2010; Glyn, 2007; Howell, 2003; Baccaro and Howell, 2011) or remain resilient (Iversen and Soskice, 2009; Martin and Swank, 2012; Martin and Thelen, 2007) when faced with increasingly mobile capital. In contrast, this paper shows that institutions of economic coordination, which are often associated with more egalitarian economic outcomes (Rueda and Pontusson, 2000; Ahlquist and Answell, 2017; Hope and Martelli, 2019) can contribute to functional income inequality when put under the strains of trade liberalization. Finally, this paper adds to a growing literature within international political economy, which looks at the domestic sources of macroeconomic imbalances (Manger and Sattler, 2019; Sattler and Haas, 2018; Baccini et al., 2018; Baccaro and Pontusson, 2016; Walter et al., 2019). By showing that labor shares in coordinated market economies drop as a response to trade liberalization, this study helps to explain an important driver of sluggish growth, financial fragilities and global imbalances.

## 2.2 Labor Market Institutions and Wage Shares

My theoretical framework centers on the idea that labor market institutions play a key role in mitigating the macroeconomic effect of increased competition on the labor share. I develop this argument in three steps. First, I briefly recap the most prominent existing theories on the decline of labor shares. Whereas these theories provide us with strong arguments on how increased competitive pressure leads to a reallocation of market shares from more labor to more capital intensive firms, they are largely silent on the role of workers. However, taking both the preferences of workers and their capacity to pursue them into account has important implications for the predictions about labor share developments. In a second step, I therefore, introduce the preferences and strategic capacities of workers in struggling firms. I argue that rising competitive pressure confronts employees with a trade-off between wages and employment and that domestic labor market institution crucially shape how they resolve this trade-off. In a third step, I build on these arguments to deduce hypotheses about the trajectories of aggregate and firm-level wage shares across different labor market institutions.

### 2.2.1 Existing Theories: Competition, Reallocation and the Labor Share

Much of the existing literature suggests that labor shares in advanced economies fall as a consequence of a structural reallocation of economic activity and market shares from more to less labor intensive firms and sectors. One of the most prominent example of an explanation along these lines is the so-called "super star" firm model introduced by Autor et al. (2017). The model rests on two important assumptions. First, following recent advances in new new trade theory (Melitz, 2003; Helpman, Melitz and Yeaple, 2004)[3], their theory starts from the assumption that firms that consider entering a market are ex ante uncertain about their own productivity and only learn about it after paying a sunk cost of market entry (Kim and Osgood, 2019; Bernard et al., 2012). This implies that firms which compete in the same sector can differ widely with respect to their productivity.

A second key assumption which Autor et al. (2017) share with many other theories on the development of labor shares is that wages are set in a decentralized manner and simply reflect market forces (see also Karabarbounis and Neiman, 2012; Dauth et al., 2017; Dao et al., 2017). This combination of firm heterogeneity and given wage costs has important

[3] See also Kim and Osgood (2019) for a detailed review of this literature

implications for the development of wage shares. If labor costs are fixed, more productive firms, by definition, employ less labor to produce the same amount of output and will hence have a lower labor share (Bartelsman, Haltiwanger and Scarpetta, 2013). At the same time, more productive firms are also better equipped to weather rising competitive pressures. If consumers or corporate buyers - for some external reasons ranging from increased import competition to technological change - become more price sensitive, less productive companies will struggle and have to reduce their output. At the same time, more productive firms will be able to adapt to increased competition and capture a larger share of the market. As a result of this “winner takes most” dynamic, the reallocation of market shares causes more output to be produced by firms with lower wage shares. On aggregate, this leads to a fall in labor’s overall share of national income (Kehrig and Vincent, 2017; Autor et al., 2017).

While the super star firm model constitutes a prime explanation for the fall of labor shares, it is not the only approach that expects the labor share to fall as a result of the reallocation of economic activity. For example, theories building on sectoral trade models, stipulate that globalization reallocates economic activity from more import-competing to more export-oriented industries (Hiscox, 2001; Walter, 2017). As import-competing industries usually have higher wages shares, their decline also implies that labor’s share in national income falls (Elsby, Hobijn and Sahin, 2013). Similarly, a range of models have predicted that technological change may also induce a reallocation of output shares from less to more capital intensive firms or sectors (Autor and Salomons, 2018; Decker et al., 2017).

So while scholars may disagree on the specific mechanisms that link competitive pressure to lower labor shares, they share the predictions that wage shares fall predominantly due to a reallocation of economic activity between heterogeneous firms and sectors and that labor market institutions only play a limited role in this process. As wage costs are assumed to be fixed and given by market forces, the preferences and strategies that employees face when their firms are confronted with rising competitive pressures, are of little concern. However, taking these preferences into account, has important implications for the ways in which of rising competition affects labor shares.

### 2.2.2 Introducing Workers: Trade-Offs, Institutions and the Labor Share

From the perspective of employees, rising competitive pressures stipulate a trade-off between wages and employment. Workers in firms that struggle with, for example, rising import competition can opt for two alternative strategies. If they prefer wages and relative income growth over job security, they may use their bargaining power to maximize their relative income. By doing so, they may be able to defend their current share of the over all income of the firm. However, they also risk that their employer is unable to keep up with the new competitive environment, has to reduce output, loses income and eventually, will lay off workers. If employees value job security over wage growth they, therefore, may also refrain from trying to maximize their own income share and instead attempt to maximize the market share of their firm as an alternative strategy. In that case, employees in firms that are confronted with mounting competitive pressure would try to strengthen their firm's competitiveness by reducing their wage claims and, thus, increase their job security at the expense of decreasing their relative income. Domestic labor market institutions will have an important influence on how employees resolve this general trade-off.

A central insight of the literature on the political economy of labor markets is that the domestic institutional environment has a large influence on whether economic actors "coordinate their activities primarily via hierarchies and competitive market arrangements" or "depend more heavily on non-market relationships to coordinate their endeavors" (Hall and Soskice, 2001, p.8). Whereas this question relates to various different aspects of institutional complementaries (e.g. Culpepper, 2011; Martin and Swank, 2012; Busemeyer and Trampusch, 2011), domestic wage setting institutions are likely to be the most decisive for the preferences and strategies of workers in struggling firms. Numerous studies have analyzed how the degree to which wages are set by market forces or the outcome of coordinated bargaining processes spanning across employees, firms and sectors influences the distribution of income (Rueda and Pontusson, 2000; Pontusson, Rueda and Way, 2002; Ahlquist and Answell, 2017), often equating more coordinated wage bargaining systems with more egalitarian economic outcomes (Thelen, 2012). However, when it comes to the wage response of employees in struggling firms, more coordinated wage bargaining systems may fuel the fall of labor shares for two reasons: They should make employees more likely to prefer job security over wage growth and they should increase their strategic capacities to pursue this preference.

First, wage setting institutions influence workers' preferences. When confronted with the trade-off between wages and employment, higher levels of wage bargaining coordination will increase workers *incentives* for wage restraint. Countries with low levels of wage bargaining coordination are often characterized by relatively flexible labor markets and education and training systems that put a strong emphasis on acquiring general skills (Hall and Soskice, 2001; Iversen, Soskice and Hope, 2016*a*). In times of economic downturns, firms in these economies can relatively easily dismiss parts of their workforce, which makes it less attractive for employees to acquire very firm or sector specific skills (Rueda and Pontusson, 2000). If their companies are hit by a competitive shock, employees in these context are likely to insist on their current income share and simply change firms or sector if high wage costs result in a reduction of the workforce. These preferences change in more coordinated wage bargaining systems. As such systems often go hand in hand with more long-term employer-employee relations, stricter labor market regulations and an encompassing vocational training system, employees in these contexts have higher incentives to invest in firm-specific skills. Often such skills are difficult to transfer to other sectors or even firms within in the same industry (Streeck and Thelen, 2005), which renders it complicated for employees to abandon their employer in times of rising competitive pressure and try their luck in other firms or industries. Given their vested interest in the survival of the firm, employees of struggling firms in more coordinated contexts, thus, have stronger incentives to curb their wage claims if they are confronted with the trade off between job security and income share.[4]

Second, wage setting institutions do not only influence the preferences that workers hold with regards to wage restraint. They also determine their capacity to actually implement this strategy. Wage restraint only makes sense as a collective endeavor. If a single worker comes to the conclusion that lowering her wage demands would serve the survival of her firm, actually doing so is only rational as long as her colleagues do the same. If not, cutting her own salary will have little effects on the competitiveness of her firm and she might end up with less money and having lost her job anyway. Wage restraint, thus, needs to be or-

[4]In addition to skill-specificity, the presence of institutions like shop-floor representation and co-determination that are often associated with coordinated wage bargaining might also provide employees with a more long-term perspective inside the firm and could therefore encourage strategic cooperation and wage restraint (Höpner and Lutter, 2014).

ganized. This is difficult to achieve in countries with largely decentralized wage bargaining systems but becomes increasingly effective the more coordinated domestic wage bargaining institutions are. At the firm-level, trade unions and employer associations in more coordinated systems, on average, simply have better institutional capacities for wage moderation. Institutions such as long-lasting job floor ties and established works councils enable employers and employees to negotiate plant level deals to curb wage growth in exchange for a commitment to maintain employment levels (Thelen, 2012). Importantly, while plant level labor representation is much more prevalent in countries with coordinated wage setting institutions, it is not exclusive to them. Even in decentralized system there might single firms or industries in which trade unions are strong enough to strike firm-level employment deals. However, these deals are likely to be less potent in decentralized systems as wage restraint becomes more effective, the broader it reaches (Driffill, 2006; Hall and Soskice, 2001). If wage moderation only occurs in a single firm, the most productive workers will always have incentives to leave the company. Centralized bargaining at the sector or industry level, therefore, needs to make sure that more productive firms, for which competitive pressure is less of a problem, have less room to undermine moderation by poaching employees away from their competitors (Campbell and Kamlani, 1997; Baccini et al., 2018). This becomes even more effective if institutions such as pattern bargaining also allow for the extension of wage restraint to non-exposed sectors and, thus, make it less attractive for employees to abandon struggling firms, for example, to seek higher wages in the public sector (Höpner and Lutter, 2014).

Existing qualitative evidence points to the fact that cooperation between capital and labor in countries with more coordinated wage bargaining institutions intensifies in times of heightened competitive pressure (Thelen, 2012). For example, German trade unions and employer associations have increasingly pushed for the establishment of so-called "Pacts for Employment and Competitiveness" (*Bündnisse zur Beschäftigungs- und Wettbewerbssicherung*) since the 1990s. These pacts involve trade-offs in which managers commit to job security and workers in exchange provide flexibility with regards to working times and wage growth (Hassel, 2014; Thelen, 2009). Another famous example of coordinated wage restraint in recent years is the fact the powerful German union for metalworkers (*IG Metall*) declined to set forth any wage demands at all in the years following the financial crisis of 2008 and instead focused entirely on job security and training (Thelen, 2012; Höpner and Lutter, 2014). Similar trends have been described in the context of other coordinated market economies such as the Netherlands as well as Austria (Visser and Hemerijck, 1997; Raess and Burgoon, 2006).

#### 2.2.3 Empirical Implications: Competition, Wage Bargaining and the Labor Share

Summing up, I argue that rising competitive pressures confront employees in struggling firms with a trade-off between wages and employment security. How workers resolve this trade-off, depends on the level of coordination in domestic wage setting institutions. The more coordinated wage bargaining is, the more likely workers will be to favor job security over wage growth and the more capable they are to follow these preferences by organizing collective wage restraint. While this strategy increases the competitiveness of less productive firms and tames the "winner takes most" dynamics in times of rising pressure (Baccini et al., 2018), it comes at the expense of a significant redistribution of income from labor to capital. This argument has a number of empirical implications.

A first empirical implication concerns the descriptive pattern of aggregate labor-share changes at the national level. The currently most prominent explanations for rising functional income inequality expect labor shares to fall due to a reallocation of economic activity (e.g. Autor et al., 2017; Elsby, Hobijn and Sahin, 2013). As wage costs are given by market forces, labor share developments are dominated by between firm effects. Less productive firms have to reduce their output and aggregate labor shares fall as an increasingly large share of total income is produced by firms with relatively low labor shares. While I agree with diagnosis, my argument suggests that it is specific to institutional contexts in which wage outcomes are predominantly shaped by market forces. The more coordinated wage bargaining systems are, the more important organized wage restraint within existing firms should become for the trajectories of wage shares. On the one hand, this implies that labor shares fall more strongly in more coordinated countries. On the other hand, it means that aggregate labor share developments are dominated by changes within existing firms rather than the reallocation of market shares between companies.

- *H1: The more coordinated wage bargaining systems are, the stronger aggregated labor shares fall and the more they are dominated by within firm developments.*

In addition to these broad macro-level trajectories, the argument outlined above also has implications at the firm level. Most specifically, we should be able to causally link decreasing firm-level labor shares to rising competitive pressure. Similar to existing research, I see rising competitive pressure as a key driver of declining wage shares. However, whereas for example the super star firm model assumes that such pressure leaves firm-level wage shares unchanged and simply pushes less productive firms out of the market, my argument suggests that coordinated wage bargaining increases employees incentives and strategic capacities to respond to heightened competition by curbing their wage claims. As a consequence, rising pressure should have a more negative effect on firm-level labor shares, the more coordinated wage bargaining systems are.[5] I thus test the following hypothesis:

- *H2: The more coordinated wage bargaining systems are, the more increased competitive pressure results in a drop of firm-level labor shares.*

Finally, my argument implies that wage restraint is the key driver of declining firm-level wage shares in contexts with more coordinated wage bargaining systems. In theory, labor shares within existing firms could drop for a number of reasons including, for example, a dismissal of large parts of the workforce and a switch to more capital-intensive forms of production (Karabarbounis and Neiman, 2012; Dauth et al., 2017). However, if wage bargaining coordination makes employees more likely to favor job security over wage growth and fosters their capacities to organize this strategy, wage moderation should be at the heart of the drop of firm-level labor shares. It is, therefore, crucial to study the specific mechanism that links rising competitive pressure to declining wage shares and I, finally, also test the following hypothesis.

- *H3: The more coordinated wage bargaining systems are, the more competitive pressure should turn firm-level wage restraint into the main driver of falling labor shares.*

In the rest of the paper, I will test these hypotheses in two steps. In the next section, I will start with decomposing labor share dynamics between and within firms across advanced

[5] An important question in the literature on the macroeconomic effects of wage bargaining centralization pertains to whether these effects are monotonic or hump-shaped (Driffill, 2006). In the latter case, very decentralized and very centralized forms of wage bargaining would, for example, produce different unemployment outcomes than intermediate cases. While the empirical jury on this question is still out in debate (e.g. Nickell, Nunziata and Ochel, 2005; Elmeskov, Martin and Scargetta, 1998; Blanchard et al., 2006), the discussion above suggests that both incentives and capacities for wage moderation should strictly increase with higher levels of coordination.

economies. I then turn to a more systematic analysis of the effect of import competition on labor shares and its interaction with domestic labor market institutions.

### 2.3 Decomposing Changes Labor Share Changes

I start the analysis with a descriptive investigation of the patterns of labor share changes across countries with different levels of wage bargaining coordination. My first hypothesis is that aggregate labor shares in countries with more coordinated forms of wage formation should fall more strongly and have a more pronounced within-firm component than in contexts in which wage setting is dominated by market forces. I investigate this implication decomposing the aggregate change of labor shares in publicly listed firms in the European Union (EU).

#### 2.3.1 Data on Firm-Level Labor Shares

The main data for all my analyses below come from the Compustat database provided by Standard & Poor's. For each firm-year observation, Compustat lists a full set of balance-sheets items, including for example, each firm's total payroll, total employment, total sales etc. together with its geographic location and different industry identifiers. I extract all publicly listed firms in the European Union (EU) during the period 1995 and 2015. Whereas data quality does not allow me to extent the analysis to years before 1995, I focus on countries within the EU for two main reasons.

First, as accounting standards differ across countries, firms in many states outside the European Union are often not legally required to publish the data needed to construct firm-level labor shares. For example, information on annual payroll is available for less than 15% of all US firm observations in Compustat. Second, my analysis on the effects of import competition on labor shares crucially hinges on exploiting trade liberalization at the EU level, which obviously only affects firms within European countries. I thus focus on EU member states for which sufficient data is available for the entire period under consideration. This results in a dataset with 8691 unique firms in 18 European countries and a total number of about 87363 firm-year observations. Importantly, the focus in the EU also allows me to study the trajectories of labor shares across different levels of wage bargaining coordination. Whereas some canonical cases of liberal market economies with very decentralized modes of wage formation such as the US and Australia are not included in the analysis, the dataset covers cases without any coordination in wage setting such as the UK, Estonia or Hungary all the way to some countries with the most centralized wage bargaining system in the world such as Finland and Belgium. For the decomposition analysis, I follow existing research convention and measure firm-level labor shares as the ratio of total labor costs over sales (Siegenthaler and Stucki, 2015; Autor et al., 2017).[6]

As Compustat only provides data on publicly listed firms, this data is not necessarily representative of the complete universe of companies in a given country. Nonetheless, it provides the best available data source to test the hypotheses outlined above for a number of reasons. First, using Compustat data allows me to compare firm-level developments across a large number of countries. Publicly listed firms are legally required to publish their annual balance-sheet data. This allows me to construct panel information and track long-term trajectories *within* firms.[7] Second, Compustat provides information for long time periods with good data quality ranging back to the mid 1990s. Given that a lot of meaningful trade liberalization took place at the end of the last millennial, this will be especially relevant for the analysis of the effect of rising competitive pressures. Finally, while publicly listed firms tend to be larger and more productive than other companies, they are also responsible for the biggest share of national output and income. Analyzing what happens in these firms, is therefore, on the one hand, in itself economically meaningful. On the other hand, as discussed above, wage restraint becomes more likely the less competitive firms are. If I am able to corroborate my hypotheses studying data from large and productive firms, this should allow us to infer similar or even more pronounced effects in non-listed companies.

### 2.3.2 Empirical Strategy and Findings

To explore whether changes in labor shares are driven by within or by between firm effects, I implement a standard decomposition analysis (Baily, Hulten and Campbell, 1992; Melitz and Polanec, 2012). These tools were originally constructed for productivity decompositions, but

[6] Ideally, I would be able to measure labor shares as the ratio of total labor costs over value-added. However, data on value-added is not readily available in Compustat and must be constructed from another of other balance-sheet items. As this information is missing for a lot of firms, doing so would, however, result in substantial data loss.

[7] Alternative data sources such as Bureau Van Dyke's ORBIS and AMADEUS only allow for the analysis of repeated cross-sections. In addition, data quality on items such as wages is much weaker (Kalemli-ozcan et al., 2015).

can also be applied to study labor shares (Autor et al., 2017). The main intuition behind the analysis is to decompose what share of the aggregate change in wage shares is the result of changes within existing firms and what fraction stems either from changes in existing firms' contribution to total output or from the fact that firms with different levels of labor shares enter and leave the market. More formally, we can write the aggregate changes of labor share between the base year ($t = 1$) and the current period ($t = 2$)[8] in a given country as:

$$\Delta Y_j = \sum_{i \in S} s_{i1}(\gamma_{i2} - \gamma_{i1}) + \sum_{i \in S}(s_{i2} - s_{i1})\gamma_{i2} + \sum_{i \in E} s_{i2}\gamma_{i2} - \sum_{i \in X} s_{i1}\gamma_{i1}, \tag{2.1}$$

where S, E and X denote the sets of surviving, entering and exiting firms in the market of country $j$ respectively. $\gamma_{it}$ denotes firm $i$'s labor share at point $t$ and $s_{it}$ denotes it's weight in the economy, measured as firm $i$'s share of sales over total sales in the economy. The first term is the within-firm sub-component. It keeps each firm's contribution to total output constant and just captures how much of the aggregate shift in labor shares is driven by changing wage shares *within* existing firms. The following three terms provide information on shifts that result from composition or *between* firm changes. The second term keeps each firm's labor share fixed at the level it had at $t_1$ and instead computes how much of the aggregate change is driven by changing weights of existing firms (i.e. what share of total labor share changes is driven by the fact that more or less capital intensive grow or shrink), the following two terms capture the effect of firms with different labor shares entering or leaving the market between the two time periods.

Figure 2.2 plots the result of this shift-share decomposition calculated for adjacent five-year periods for firm-level labor shares and then cumulated over the period from 1995-2015. It calculates *within* effects (first term in (1)) and composition effects (terms 2-4 in (1)) for each country separately and then takes averages of these outcomes across different levels of wage bargaining coordination. I measure coordination using the wage bargaining coordination index provided by Visser (2015). This variable ranges from 1 to 5 and measures "the degree of intentional harmonization observed in the wage-setting process". It will be described in

[8] Note that 5 year changes in the firm-level data forms the basis for the decomposition analysis

more detail in the following section.[9] Separate results for each country can be found in 2.B.3 in the supplementary materials (SM).

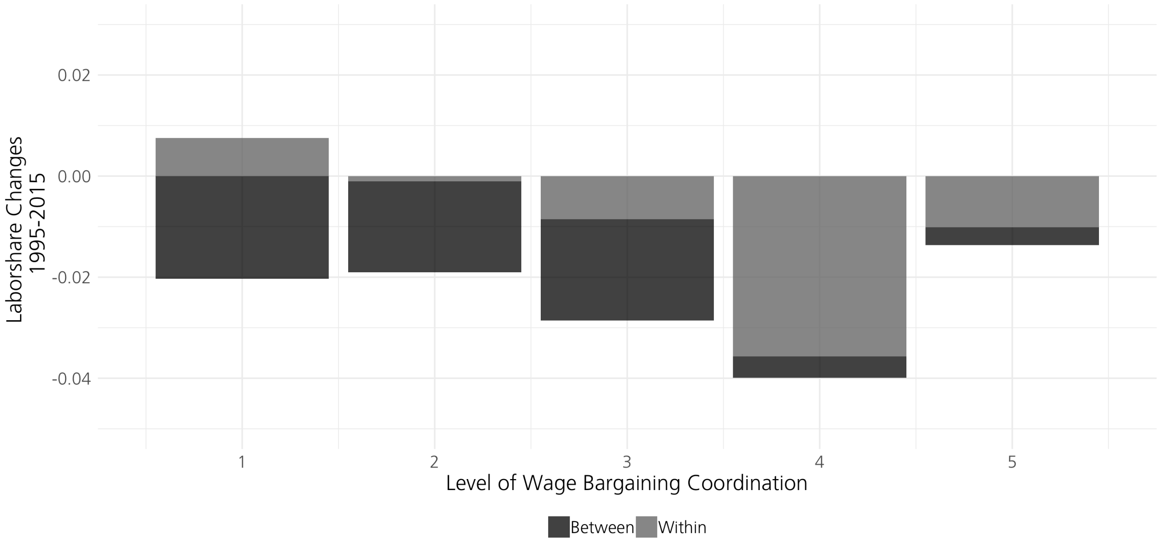


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FIGURE 2.2: Each bar represents the average cumulated sum of a shift-share decomposition of labor-share dynamics in publicly listed firms over adjacent five-year intervals between 1995-2015 for countries across different levels of wage bargaining coordination.

A couple of main results stand out. First, Figure 2.2 shows that changes in the aggregate labor share of publicly listed firms in countries with largely decentralized forms of wage bargaining are dominated by between firm changes. This in line with previous findings by Autor et al. (2017) and confirms the idea that in contexts in which wages are mainly set by market forces, the fact that companies with lower labor shares increasingly capture larger market shares is an important driver of falling wage shares.[10] However, this pattern looks differently in more centralized countries. The more coordinated wage bargaining systems get, the more important within firm developments become for the trajectory of labor shares. In countries with highly coordinated bargaining institutions, the within firm component clearly outweighs changes that result from a reallocation of market shares. This is broadly in line with the argument, that wage restraint plays an important role in contexts in which wage setting is shaped by more intentionally harmonized processes. Finally, Figure 2.2 also

[9] The index takes the following values for the countries in the dataset. 1 (United Kingdom, Estonia, Hungary, Poland); 2 (France, Czech Republic, Greece, Portugal); 3 (Spain, Italy, Luxembourg); 4 (Austria, Germany, Denmark, Netherlands, Sweden); 5 (Belgium, Finland)

[10] Figure 2.2 also suggests that labor shares within existing firms in countries without wage bargaining coordination have even increased. However, this result is driven by UK where large spikes in the salaries of financial sector professionals have contributed positively to overall wage share developments (Denk, 2015).

provides some suggestive evidence in favor of the hypothesis that more coordinated wage bargaining systems result in a stronger decline of labor shares. Whereas the aggregate wage share in publicly listed firms fell only by about 1 percentage point between 1995 and 2015 in highly decentralized countries, it decreased on average by almost four times as much in countries with the second highest score on the coordination index. However, the descriptive picture also shows coordination alone cannot explain total changes. Belgium and Finland are the only two countries in the sample that have a coordination index of 5. However, their average wage shares fell less than in other countries with more decentralized wage setting institutions. Against this background, the next section delves further into the question how wage bargaining coordination interacts with changes in the level of competitive pressures in pushing down firm-level labor shares.

## 2.4 Import Competition and Wage Shares

The previous section has established descriptively that aggregated firm-level labor shares in countries with more coordinated wage bargaining systems, on average, fell faster and were to a larger extent driven by within firm changes than in countries with more decentralized modes of wage formation. I now turn to analyzing to which degree these changes were a response to increased competitive pressures.

### 2.4.1 Research Design & Empirical Strategy

To study the effect of increased competition on firm-level labor shares, I am interested in estimating the following model:

$$Y_{it} = \beta_0 + \beta_1 \Delta IMP_{ict} + \beta_2 Coord_{ct} + \beta_3 \Delta IMP_{it} \times Coord_{ct} + \beta_4 X + \delta_i + \delta_t + \epsilon_{ict}, \tag{2.2}$$

in which $Y_{it}$ the labor share in firm $i$ at point $t$, changes in competitive pressures is measured in import competition and denoted as $\Delta IMP_{ict}$, $Coord_{ct}$ represents different indicators of wage bargaining coordination in country $c$ and $X$ depicts a number of covariates at the firm and the country level. Finally, $\delta_i$ nets out time invariant firm specific effects and $\delta_t$ are year fixed effects that control for overall trends in firm-level labor shares. My key variable of interest is $\beta_3$ which measures how much the effect of increased competition on firm-level labor shares changes over different levels of wage coordination and which I expect to be negative. Below, I describe variable measurement and identification in more detail.

Labor Shares and Import Competition: Measurement and Identification

My main variable of interest is the labor share per firm per year. As before, I use Compustat data and measure labor share as the ratio of wage costs over sales. A potential problem with this approach is that Compustat does not distinguish between different firm branches and only provides consolidated information at the headquarter level. This could be problematic if changes in the total labor share of a firm a driven by establishments that are not located in the same country as the headquarter and are thus subject to different wage bargaining structures. I warrant against this issue by merging Compustat with Thomas Reuters information on foreign subsidiaries and making sure that my findings are robust to dropping firms with foreign establishments. More details on the distribution of this variable can be found in Figure 2.B.2 of the supplementary materials (SM).

My first main explanatory variable are changes in the level of competitive pressures that firms are exposed to. Whereas in theory, competitive pressures could originate from a range of sources including, for example, technological change or product market deregulation, in the empirical analysis I focus on the effects of trade for mainly two reasons. First, globalization and rising import competition is often discussed as a key driver of rising inequality and falling labor shares (Elsby, Hobijn and Sahin, 2013; Dao et al., 2017), it also has turned into one of the politically most contested sources of structural economic change in recent years (Baccini et al., 2018; Frieden, 2018). Analyzing how the effect of trade liberalization differs across different institutional set ups is, thus, substantially interesting in itself. Moreover, as I will discuss in more detail below, the fact that trade liberalization is a much more guided and, thus, potentially exongenous process than, for example, technological innovations, render it a more useful set up to parse out the effect heightening competition on labor shares.

$\Delta IMP_{ict}$, therefore, denotes the change of import competition a firm is exposed to in a given year. The most straightforward way to measure this would be to simply look at how imports into the main sector a firm is active in increase. However, this could cause a number of issues. Industries experiencing an increase in import penetration might differ from industries facing no such rise. This could pose a threat to identification if, for example, industries that become more capital intensive also import more intermediary inputs or if foreign exporters strategically target markets with rising wage costs. In any case, rising import competition is unlikely to be completely exogenous to labor share trajectories.

I circumvent this problem in two ways. First, I exploit *de jure* changes in import competition. For this, I rely on the fact that in the EU all trade policy with non-member countries is conducted by the European Commission. Given the bureaucratic nature of these negotiations and the fact that the Commission negotiates on behalf of all 28 member states at the same time, it is unlikely that tariff concessions made towards third countries are shaped by the labor share developments of specific industries in specific countries. Moreover, trade liberalizations are usually the result of long, drawn-out processes, in which packages deals for up to 5000 product lines are negotiated at the same time and usually take up to X years. Even if member states are able to shift negotiation outcomes with regards to wage developments in specific industries, this makes it very unlikely that they are able to determine the exact *timing* at which trade liberalization takes place. Tariff cuts thus provide us with a plausible source of exogenous variation in import competition.

I take data on EU level tariff cuts with third countries form Baccini, Pinto and Weymouth (2017). The dataset contains preferential tariff concessions made by the EU in all Preferential Trade Agreements signed between 1995 and 2015.[11] It provides information on tariff schedules at a very disaggregated product level of the Harmonized Commodity Description and Coding System (HS6) listing average tariffs before the entry into force of a PTA as well as all subsequent cuts until the end of the implementation period (Baccini, Pinto and Weymouth, 2017). From this, I add up all import tariff cuts made by the EU in a given year and use conventional correspondence tables to aggregate them to the industry level (SIC 4 Digit). Details on the exact construction of the variable are in the SM.

In a first step I, thus, analyze how de jure increases in import competition caused by EU import tariff cuts affect the labor share of a given firm in a given industry. However, while tariff cuts provides us information on potential increases in import competition, they do not say much about actual trade flows.[12] In a second step, I therefore use tariff cuts to

[11] As trade liberalization stemming from PTAs only affects EU member states, I include observations from countries that joined the EU after 2004 and 2007 only after their accession.

[12] In a potential outcomes framework, tariff cuts would correspond to the intention to treat (ITT) effect.

instrument real trade flows. More formally, I implement an IV regression in which $\Delta IMP_{ict}$ is substituted by $\Delta I\hat{M}P_{ict}$, denoting the fitted values of a first stage regression of $\Delta IMP_{ict}$ on a sector level tariff cuts. This approach should get us closer to the actual effect of increased import while circumventing the potential endogeneity problem of rising import competition in a standard OLS. I measure import growth as the log difference in sector-level imports into the EU for each year. Data is provided on a quarterly basis for detailed product codes (HS6) by COMTEXT (EU, 2019). I aggregate imports by year and across all trading partners and use standard correspondence tables to match them to the industry SIC codes used in Compustat.

Measurement of Wage Bargaining and Controls

My second main independent variable are labor market institutions. More specifically, I am interested in the extent to which wage setting systems are coordinated. The more coordinated the wage setting process is, the more employees should be willing and able to respond to increased import competition by strategically curbing their wage demands. For my main analyses, I measure economic coordination as wage bargaining coordination using a variable from the ICTWSS database, which provides yearly values of an index of wage bargaining coordination developed by Kenworthy (2001). This proxy measures "the degree of intentional harmonization observed in the wage-setting process" (Kenworthy 2001, 76), that is, the extent to which economic actors (especially trade unions and employer associations) align their wage negotiation behavior. The variable is ordinal, ranging from one ("Fragmented wage bargaining, confined largely to individual firms or plants") to five ("Maximum or minimum wage rates/increases based on centralized bargaining"), and it captures the level to which wages and salaries are determined by market forces or the outcome of coordinated negotiations. In countries scoring one (e.g., the UK), negotiations about wages take mainly place between individual workers (or plant-level trade unions) and their employers. The more a country has a wage-setting dynamic that limits (formally or informally) this tendency, the more I expect employees to be able to engage in strategic and coordinated wage restraint.

While I believe that this measure comes closest to capturing the most relevant dimension of economic coordination for my argument, I also make sure that my findings are robust across other measures of labor market coordination, including wage bargaining centralization, the share of wage earners that is covered by wage bargaining and the strictness of labor market regulation. Whereas the former two provide alternative measures of the institutional *capacities* for strategic wage restraint, stricter labor market regulation should make it more likely for workers to build long-term relations with their workplace and invest in firm specific skill and thus positively influence employees *incentives* to forfeit wage growth when confronted with rising import competition. Details on the construction of these variables can be found in the SM (p. 10).

Finally, I also include a number of controls. At the firm level, I control for the size of the company measured as the log of total sales as firm size and productivity have been found to be crucial determinants of firm-level labor shares (Siegenthaler and Stucki, 2004; Autor and Salomons, 2018; Dao et al., 2017). I also control for the capital intensity of a firm by measuring the total value of its property, plant and equipment. The more firms rely on capital relative to labor input, the smaller labor shares should be (Autor et al., 2017). Additionally I control for a range of time varying country level factors that might influence labor share trajectories. Most importantly, these measures include real GDP growth, the rate of unemployment, trade union density and the cost of capital, measured as real interest rates. Variable sources and summary statistics can be found in the SM (Table 2.B.1).

### 2.4.2 Analysis

The analysis proceeds in two steps. First, I look at the effect of de jure tariff cuts on firm level labor shares. Second, I implement the IV regression, estimating the instrumented effect of import growth on labor shares across different levels of coordination. Finally, I analyze what drives these changes in labor shares. More specifically, I explore whether declining labor shares actually correspond to wage restraint.

#### Main Results

Table 2.1 presents the main findings for the analysis of de jure tariff cuts on changes of firm-level labor shares. Model (1) shows the simple correlation between tariff cuts, levels of wage bargaining coordination and within firm changes in labor shares, model (2) adds year fixed effects and the relevant controls and model (3) introduces the interaction term between trade liberalization and coordination as the main variable of interest.

Table 2.1: The Effect of De Jure Tariff Cuts on Firm-Level Labor Shares

| | *Dependent variable:* | | |
|---|---|---|---|
| | Firm Level Labor Share | | |
| | (1) | (2) | (3) |
| Tariff Cut | −0.072 | −0.040 | 0.019 |
| | (0.039) | (0.034) | (0.018) |
| Coordination | 0.444*** | 0.273* | 0.284* |
| | (0.101) | (0.117) | (0.117) |
| Tariff Cut x Coordination | | | −0.051** |
| | | | (0.016) |
| Controls | × | ✓ | ✓ |
| Year Fixed Effects | × | ✓ | ✓ |
| Firm Fixed Effects | ✓ | ✓ | ✓ |
| Observations | 76,535 | 65,565 | 65,565 |
| $R^2$ | 0.774 | 0.783 | 0.783 |
| *Note:* | *p<0.05; **p<0.01; ***p<0.001 | | |

Coordination measures the level of wage bargaining coordination. Firm-level controls include the logged value of total sales and the capital stock (measured as the overall value of all property, plant and equipment). Country-level controls include real GDP growth, unemployment rate and real interest rates. All standard errors are clustered at the industry level. Full models are in Table 2.C.2 in the SM.

Three results are especially relevant. First, in line with idea that trade liberalization only affects within-firm changes in countries with coordinated wage bargaining systems, tariff cuts have no significant effect on the development of firm-level labor shares if we take into account firms in all European countries. Second, disregarding exposure to increased price competition, firm-level labor shares in countries with more coordinated modes of wage-bargaining have developed slightly more positively. Given that without heightened price competition, wage coordination should increase employees bargaining power vis-a-vis their employers, this is again what we would expect. Third and most importantly, Table 2.1 shows that the interaction term between wage bargaining coordination and tariff cuts is negative. The more coordinated the wage bargaining system in which firms operate is, the more trade liberalization leads to a decline in firm-level labor shares.

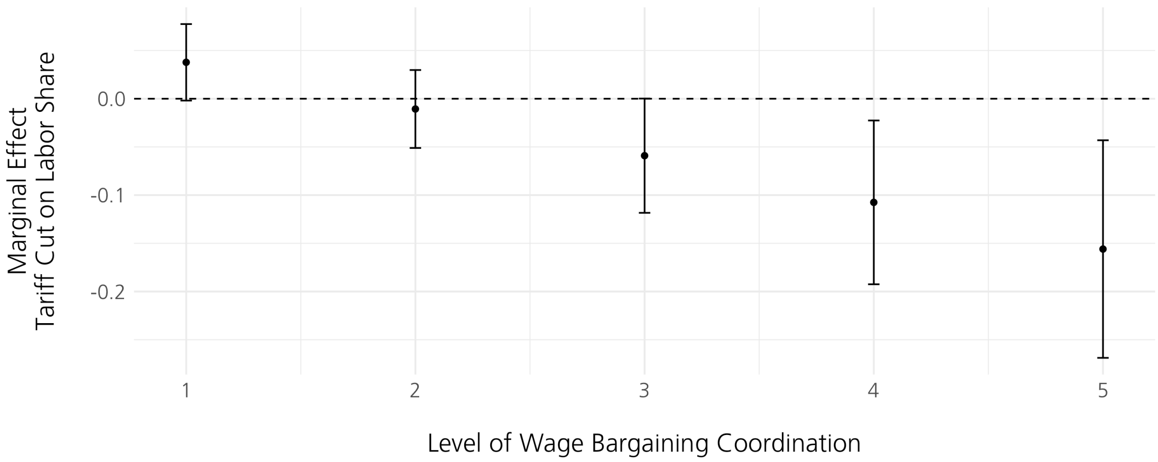


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Figure 2.3: Marginal Effects of De Jure Tariff Cuts on Labor Shares Across Different Levels of Wage Bargaining Coordination. Estimates correspond to Model (3) in Table 2.1.

To facilitate the interpretation of this interaction term and to make sure that these differences are actually statistically significant (Brambor et al., 2006), Figure 2.3 plots the marginal effect of tariff cuts on firm-level labor shares at different levels of wage bargaining coordination. The results are in line with the argument suggested above. As expected, at low levels of coordination, the effect of trade liberalization on labor shares is close to zero and statistically insignificant. This corresponds to the argument that if wages are the result of decentralized market forces, increased competitive pressure leaves firm-level labor shares unchanged. However, in line with the expectation that incentives and capacities for wage restraint increase with higher levels of wage bargaining coordination, the effect of import

Table 2.2: The Effect of Import Growth on Firm-Level Labor Shares

| | *Dependent variable:* | | | |
|---|---|---|---|---|
| | Firm Level Labor Share | | | |
| | OLS | OLS | OLS | IV |
| Log Import Growth | 0.17 | −0.10 | 0.20 | 0.55 |
| | (0.18) | (0.16) | (0.22) | (1.40) |
| Coordination | $0.41^{***}$ | $0.27^{*}$ | $0.34^{**}$ | $0.60^{**}$ |
| | (0.10) | (0.12) | (0.12) | (0.22) |
| Log Import Growth x Coordination | | | −0.12 | $-2.06^{*}$ |
| | | | (0.10) | (0.91) |
| Controls | × | ✓ | ✓ | ✓ |
| Year Fixed Effects | × | ✓ | ✓ | ✓ |
| Firm Fixed Effects | ✓ | ✓ | ✓ | ✓ |
| K-P weak identification test (F) | | | | 18.22 |
| Observations | 76,535 | 65,565 | 65,565 | 65,565 |
| $R^2$ | 0.73 | 0.78 | 0.76 | 0.78 |

$^{***}p < 0.001$, $^{**}p < 0.01$, $^{*}p < 0.05$

Coordination measures the level of wage bargaining coordination. Logged import growth gives total import growth into the EU measured at the SIC 4 digit level. Firm-level controls include the logged value of total sales and the capital stock (measured as the overall value of all property, plant and equipment). Country-level controls include real GDP growth, unemployment rate and real interest rates. All standard errors are clustered at the industry level.

competition on labor shares turns increasingly negative and becomes statistically significant for values of 3 or higher on the coordination index. In highly coordinated systems, a 10 percentage point tariff cut, leads the labor shares of firms in affected industries to drop by about 1.5 percentage points.[13]

Next, I turn to analyzing the effect of de facto trade flows instead of de jure tariff cuts. A legitimate concern with looking at PTA tariff cuts only would be that preferential tariff cuts are on average small, most EU country partners are small and less developed and tariff cuts might therefore not actually to a relevant increase in import competition. Furthermore, based on de jure measures of trade liberalization it is hard to disentangle whether labor shares drop as a result of actual import competition or simply due to anticipated price pressure.

Table 4.1 therefore introduces logged import growth into the EU as an alternative measure of trade-induced import competition. Columns 1-3 show results for simple OLS esti-

[13] The results show average effects for all firms active in a specific sector in a specific country. As discussed above, wage restraint should most likely to occur in less productive firms, which would find it more difficult to survive without their employees reducing their wage claims. Ideally, I would therefore be able to test a triple interaction between import competition, wage bargaining coordination and a measure of firm-level productivity. However, since total factor productivity for firms is measured as the residuals of a production function calculated for each sector-year separately, including this measure in my analysis results in too many missings to draw meaningful inference. However, as very productive firms are usually in a minority, the fact that I find a negative average effect is in line with the rationale suggested in the argument.

mates. Estimates remain similar to the results of de jure tariff cut with the exception of the interaction term between trade liberalization and wage bargaining coordination not gaining standard levels of statistical significance. However, given that sector-level import growth is unlikely to be exogenous to labor-share trajectories, column 4 applies the IV strategy instrumenting import growth with de jure tariff cuts to account for potential endongeneity. The first stage diagnostics show that the instrument is relevant: The IV's coefficient in the first stage ($\alpha = 0.038$) is highly significant ($t = 4.264$, $p < 0.001$) and the Kleibergen-Paap (K-P) statistics pass standard tests of instrument relevance.[14] In the IV regression, the coefficient of the main interaction term of interest becomes much larger and again statistically significant. As before, Figure 2.4 plots the marginal effect of instrumented import growth on firm-level labor shares across different levels of wage bargaining coordination. Similar to the results for de jure tariff cuts, trade liberalization has no effect on labor shares in liberal market economies, but significantly decreases wage shares in firms operating in systems with higher degrees of wage bargaining coordination. In highly coordinated countries, an increase of logged import growth by one standard deviation (0.766) reduces firm-level labor shares by about 5.75 percentage points.

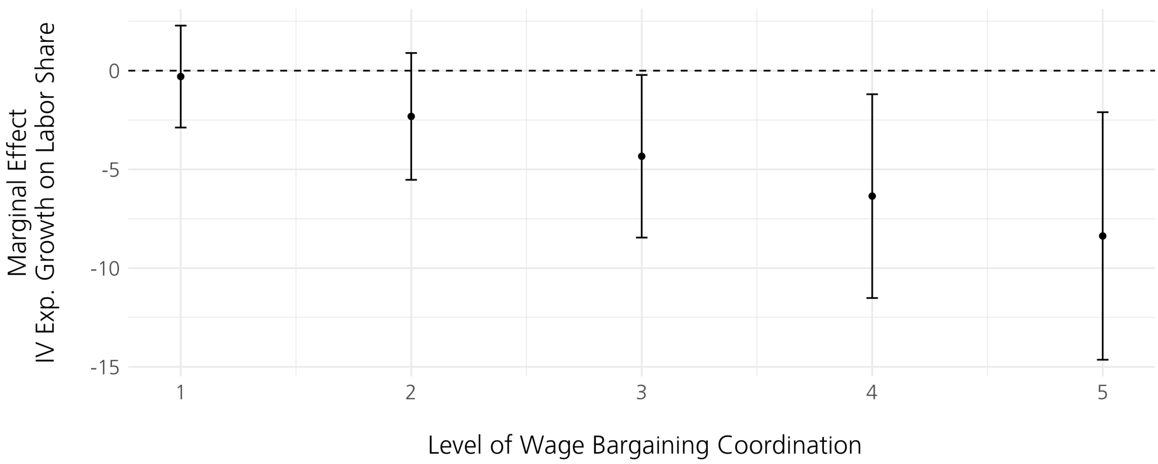


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FIGURE 2.4: Marginal Effects of Instrumented Import Growth on Labor Shares Across Different Levels of Wage Bargaining Coordination. Estimates correspond to column (4) in Table 4.1.

[14]The Kleibergen-Paap weak identification F-statistics show that the IV surpasses the relevant thresholds calculated by Stock and Yogo (2005), i.e., 16.38 for the regressions with one endogenous regressor and 7.03 for the regressions with two endogenous regressors. Surpassing these critical values ensures that the 2SLS size distortion potentially resulting from weak identification is smaller than 10%.

Robustness and Alternative Measures of Coordination

I employ a range of robustness tests. First, labor shares in industries implementing trade liberalization might be on different trends than industries without tariff cuts. I therefore include industry-specific time trends to find support for the parallel trend assumption that is implicit in my de jure analysis. Column 1 in Table 2.C.4 in the SM shows that this does not change the results substantially. Results are furthermore robust to the inclusion of a lagged dependent variable on the right-hand side of the model as well as to the introduction of an alternative measure of trade liberalization, which weighs tariff cuts by the value of sector-specific product imports from the PTA partner countries[15] (columns 2 & 3 in Table 2.C.4). Furthermore, PTAs are often negotiated based on package deals, in which both the EU and its trading partners agree to reduce tariffs at the same time. As a placebo test, I therefore repeat the analysis using export instead of import tariff cuts. As column 4 in Table 2.C.4 shows, increased export opportunities leave firm-level labor shares unchanged, which further supports the argument that dropping wage shares in more coordinated market economies actually stem from increased import competition.

Another possible concern with regards to the findings presented is that measures of coordination could pick up a range of other country characteristics that are often associated with more coordinated market economies and have an independent effect on the trajectories of labor shares. To warrant against this problem, I show that my findings regarding market coordination are robust to the inclusion of additional interaction terms between trade liberalization and other country characteristics including trade union density, measures of left-party cabinet power and different aspects of welfare state generosity. Details on possible direction and measurements of these confounders are presented in section 2.5 in the SM. Table 2.C.5 shows that including additional interaction terms does not change the substance of my findings and even increases the magnitude of the negative interaction coefficient between trade liberalization and market coordination in some specifications.

Finally, Tables 2.D.6 and 2.D.7 in the SM show that both my de facto as well as my IV estimations are robust to the usage of alternative measures of market coordination. As discussed above, I use wage bargaining centralization and the share of the workforce that is covered by wage agreements as alternative measures for institutional capacities for organized

[15] For the details of this alternative measure, see p.1 in the SM and Baccini et al. (2018)

wage restraint. Moreover, I use the strictness of labor market regulation as a measure for the incentives employees have to curb wage demands in the context of heightened import competition. The intuition behind this proxy is that stricter labor laws should lead employees to acquire more firm-specific skills and thus become more dependent on their current employer. Results remain similar to before. Independent of the specific measure of labor market institutions, higher degrees of coordination lead to a more negative effect of trade liberalization on labor shares.

### Mechanisms and Further Implications

So far, this paper has presented evidence that rising import competition causes firm-level labor shares in countries with more coordinated wage bargaining systems to fall. I now turn to testing my final hypothesis (H3), namely that the fall in labor shares is actually driven by wage restraint on the part of employees. In theory, firm level labor shares can drop for a number of other reasons including, for example, a turn towards more capital intensive forms of production or a layoff by large parts of the workforce (Karabarbounis and Neiman, 2012; Dauth et al., 2017). To further investigate the implications of my argument, Table 2.3 therefore provides evidence in line with the idea, that labor market coordination actually leads employees to curb their wage demands when facing globalization pressures.

First, it's hard to tell whether employees in more coordinated contexts engage in wage restraint by looking exclusively at the trajectories of firm-level wage shares. This ratio could fall if wage growth stays the same or even increases as long firm-level profits rise faster than firm-level wages. To test whether employees actually curb their wage claims as response to rising competitive pressure, models (1) and (2), therefore, analyze the effect of trade liberalization on firm-level wage growth, measured as the annual change in total staff expenses using both de jure tariff cuts and instrumented import penetration. In line with the argument that wage restraint needs to be organized, increased import exposure has no effect on firm-level wage growth in countries with largely decentralized systems. However, the more coordinated wage bargaining institutions are, the more import competition leads to a significant reduction of total annual staff expenses.

Second, an alternative explanation for decreasing wage shares in more coordinated wage bargaining systems would be that employers in these contexts are more inclined to substi-

TABLE 2.3: Mechanism

| | *Dependent variable:* | | | | | |
|---|---|---|---|---|---|---|
| | Wage Growth | | Employee Changes | | Profits | |
| | De Jure | IV | De Jure | IV | De Jure | IV |
| | (1) | (2) | (3) | (4) | (5) | (6) |
| Δ Import | 0.009 | 0.402 | 0.005 | 0.253 | −0.021** | -1.488* |
| | (0.006) | (0.003) | (0.005) | (0.003) | (0.008) | (0.614) |
| Coordination | 0.085*** | 0.128** | 0.046*** | 0.065** | −0.230*** | -0.205** |
| | (0.031) | (0.051) | (0.015) | (0.030) | (0.041) | (0.064) |
| Δ Import x Coordination | −0.009*** | −0.385** | −0.005 | −0.197 | 0.015** | 0.540** |
| | (0.003) | (0.176) | (0.003) | (0.145) | (0.005) | (0.250) |
| Controls | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Year Fixed Effects | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Firm Fixed Effects | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Observations | 65,564 | 65,672 | 47,488 | 47,577 | 49,922 | 49,922 |
| $R^2$ | 0.197 | 0.185 | 0.227 | 0.214 | 0.891 | 0.888 |

*Note:* *p<0.05; **p<0.01; ***p<0.001

Coordination measures the level of wage bargaining coordination. For de jure analyses, Δ import gives import tariff cuts. For the IV regressions, it measures instrumented logged import growth. Wage growth is measured as logged annual changes in total staff expenditures, employee changes as logged annual changes in numbers of employees and profits as logged gross profits. Firm-level controls include the logged value of total sales and the capital stock (measured as the overall value of all property, plant and equipment). Country-level controls include real GDP growth, unemployment rate and real interest rates. All standard errors are clustered at the industry level.

tute labor with capital input if they confront mounting competitive pressure, which is the argument mechanism behind much of the literature on the effect of technological change on labor shares (Karabarbounis and Neiman, 2012; Dauth et al., 2017). In this case, labor shares as well as wage growth would not fall as a result of wage moderation on the part workers but simply because firms reduce their workforce and invest in machinery instead. To exclude this potential alternative explanation and to provide further evidence in line with the mechanisms at the heart of my argument, models (3) and (4) show that the decline in wage growth is not driven by a reduction of employees. Instead, trade exposure leaves the number of firm-level workers unchanged both in more decentralized and in more coordinated wage bargaining systems.

Finally, the argument that wage restraint drives declining labor shares in countries with more coordinated wage bargaining systems is also supported by the development of profits. As discussed above, the main rational for employees to engage in wage moderation should be to safeguard their jobs by reducing the negative impact of increased import competition on their firm's revenues. If this were the case, we should be able to see that larger levels of wage bargaining coordination actually cushion the effect of import competition on firm-level profits. Models (5) and (6) in Table 2.3 provide evidence in line with this rational. Increased import exposure significantly reduces the firms' profits in countries with highly decentralized modes of wage formation. However, the more coordinated wage bargaining systems are, the more this negative effect decreases. In fully coordinated systems, it even turns positive, though it remains statistically insignificant.

Summing up, the findings presented in this section suggest that domestic labor market institutions play an important role in explaining the global patterns of falling wages shares. The more coordinated domestic labor markets are, the more firm-level labor shares drop as a respond to trade liberalization. Furthermore, this effect seems be driven by wage restraint instead of an adjustment of the labor force and mitigates the negative repercussions of import competition on firm-level profits.

### 2.5 Conclusion

The global decline of labor shares is not only at odds with conventional economic wisdoms. The fact that an increasingly growing slice of the national income ends up in the hands of capital owners also fuels economic inequality and contributes to sluggish growth and macroeconomic imbalances.

Much of the existing literature has ascribed this trend to broad, structural factors, an increase in market concentration and the reallocation of economic activity towards more capital intensive firms, sectors and forms of production. While I agree with this general diagnosis, this paper has argued that existing theories overlook the role that the preferences and strategic capacities of workers play in this process. Rising competitive pressure confronts employees in less productive firms with a trade-off between wages and employment. The more coordinated domestic wage bargaining systems are, the more likely workers should be to prefer job security over wages and the more capable they should be to follow this preference. As a result, import competition leads to more wage restraint and a larger reduction of firm-level labor shares, the more coordinated national wage bargaining systems are. I test this claim using a panel of balance-sheet data from publicly listed firms in 18 European countries. I exploit plausibly exogenous variation in import competition stemming from tariff cuts negotiated in PTAs at the EU level. I find evidence for my argument at the aggregate level, by using both de jure tariff cuts and instrumented import growth and across a broad range of robustness tests.

For theory, the finding that labor shares in more coordinated market economies fall not only more strongly but also for different reasons than in decentralized wage bargaining systems contribute to a more nuanced understanding of wage share dynamics. This has important implications for the analysis of global wage share trajectories (e.g. Karabarbounis and Neiman, 2012), our understanding of the potency of national labor market institutions in times of globalization (Glyn, 2007; Thelen, 2014) and theories about the domestic sources of global imbalances (Sattler and Haas, 2018; Manger and Sattler, 2019). It also re-emphasizes that economic effects of globalization differ across institutional contexts and that it is problematic to generalize from solely from the case of the US. My findings are, thus, in line with recent work by Baccini et al. (2018), who show that wage bargaining coordination tames the "winner-takes-all" effects of trade liberalization and distributes the fruits of globalization more evenly across firms. However, my findings also suggest that this comes at the expense of a significant redistribution of income from labor to capital. For policy, this suggests that different countries will have to develop different strategies to address trends towards rising functional income inequality.

A number of shortcomings of this study should be addressed in future research. First, my argument suggests that employees' response to rising competitive pressure depends on their relative preference and strategic capacity for wage restraint. Whereas both should on average be more prevalent in countries with coordinated wage bargaining systems, similar arguments could also be made about variation at the subnational level. Even in highly decentralized countries, there might be single industries or sectors were skill specificity and bargaining coordination developed enough, that wage restraint becomes a likely outcome. Future research should, therefore, further explore the role of firm and sector level variation in workers' preferences and capacities for wage restraint.

Second, my empirical analysis is exclusively based on publicly listed firms. While these firms constitute a substantial share of output and employment in most countries, they are by no means representative of the entire universe of firms. To make sure that the mechanisms proposed also applies to firms which are smaller or remain unlisted for different, we therefore need more encompassing firm-level panel data across different countries. Third, my design studies the effects of trade liberalization between Europe and partner countries that are often smaller and much less developed. Future iterations of this work should dig deeper into the effects of liberalization between trading partners that are more on par with each other. Finally, much of the recent literature on the effects of trade emphasize firm-level heterogeneity in productivity (Kim and Osgood, 2019). While data limitations keep me from analyzing how labor share dynamics differ across firm-level productivity, it is obvious that competitiveness crucially influences the incentives for wage restraint. Future research should thus study the relation between productivity, wage restraint and liberalization in more detail.

# Supplementary Materials

## 2.A Construction of Trade Liberalization Variable

In constructing the measure of European tariff cuts, I largely follow Baccini, Pinto and Weymouth (2017). For the purpose of transparency, I briefly recap the main steps of constructing this variable here. Note that the procedure is to a large extent similar to the steps explained in Baccini and Dür (2018).

1. Baccini, Pinto and Weymouth (2017) have collected data for each preferential trade agreement (PTA) signed by the European Union (EU) since 1995. For each of these agreements, the authors list provide information on tariffs for all products included at the HS 6 digit level. These information include the preferential tariffs (PRF) at $t_0$, i.e. the year of ratification, and and in all subsequent years until the tariffs reaches zero (up to 22 years). The data thus lists the entire phase-out tariff period for each product in each EU PTA. In addition, the dataset also contains the Most-Favored Nation tariff for each product before the implementation of the PTA, which I use as the baseline for the tariff cut.

2. Based on this data, I create a tariff cut variable for each product in each PTA. In the year of the ratification of the PTA, the tariff cut is the difference between the PRF and the MFN. In all subsequent years, it is the difference between the lagged and the current PRF, i.e. $PRF_{t-1} - PRF_t$.

3. For the robustness tests, I also create a weighted tariff cut by dividing the tariff cuts for each product by the value of product exports from the partner country into the EU.

4. I then sum all the tariff cuts (weighted and non-weighted) across all EU PTAs for a given product in a given year. This gives me the measure of product-level trade liberalization.

5. To merge with the COMPUSTAT firm data, I use existing crosswalk tables to sort all products into their corresponding 4-digit industry codes of the Standard Industrial Classification (SIC).

6. Finally, I take the average value of all my measures of tariff cuts (weighted and not weighted) in each year to move from HS 6-digit to SIC 4-digit. Importantly, I do not sum all tariff cuts in this case because there are different numbers of 6-digit products in 4-digit industries. For each industry, where there is no corresponding product mentioned in any of the PTAs, I set the tariff cut in the respective year to 0.

To give an overview of this liberalization measure, Figure 2.A.1 plots yearly average tariff cuts between 1995 and 2015 across industries. Note that while for the analysis, I use average tariff cuts at the much more fine grained SIC 4 digit level, for the purpose of readability, Figure 2.A.1 presents averages at the SIC 2 digit level.

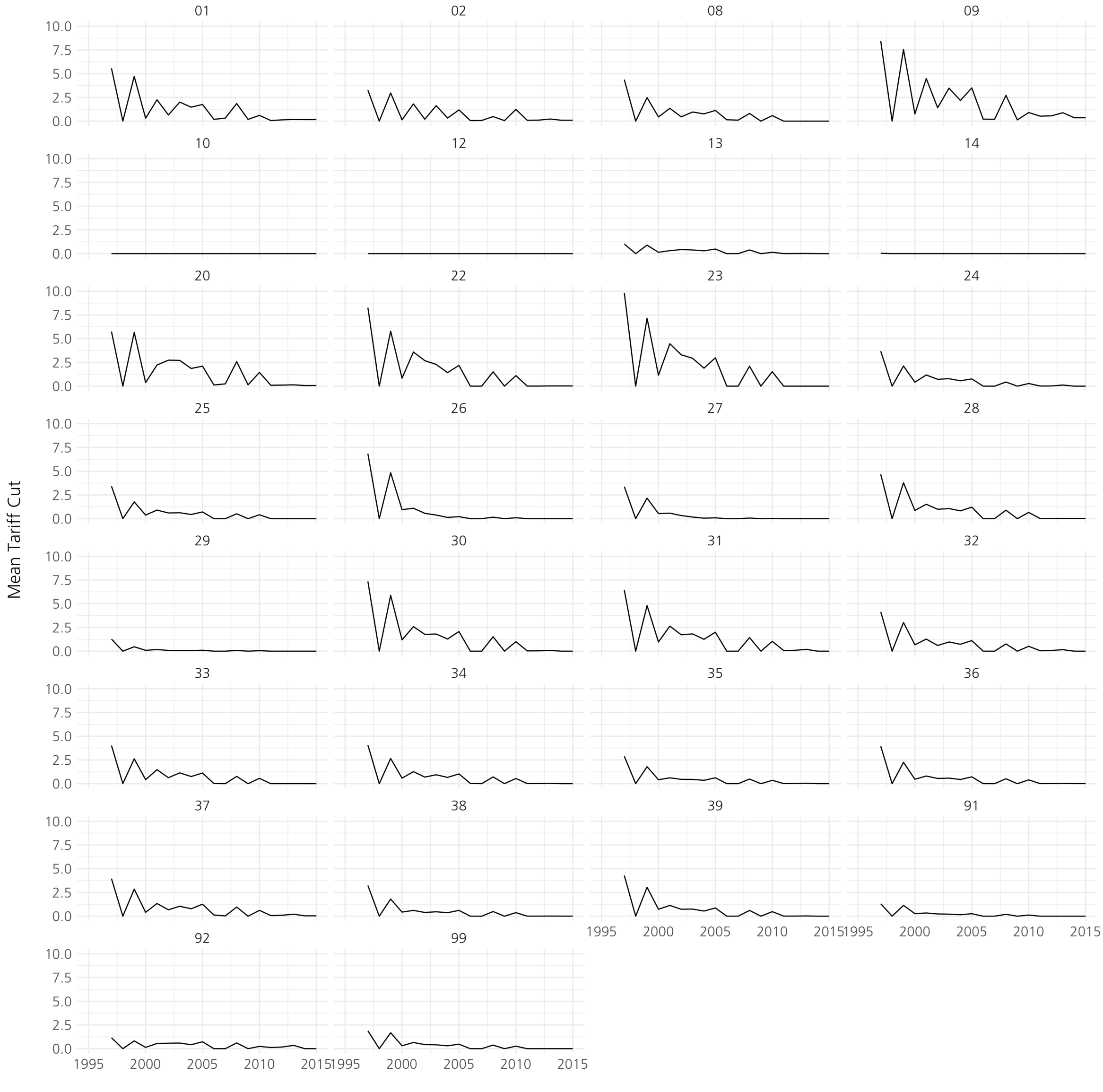


FIGURE 2.A.1: Yearly average tariff cuts between 1995 and 2015 at the SIC 2 Digit Industry Level.

## 2.B Descriptives & Summary Statistics

Table 2.B.1: Summary Statistics

| Statistic | N | Mean | St. Dev. | Min | Max |
|---|---|---|---|---|---|
| Firm Level Labor Share | 93,220 | 79.821 | 15.034 | 0.001 | 100.000 |
| Tariff Cut | 93,220 | 0.215 | 1.141 | 0 | 75 |
| Log. Import Growth | 93,220 | 0.158 | 0.767 | −4.432 | 5.515 |
| Coordination | 81,822 | 2.717 | 1.319 | 1.000 | 5.000 |
| Log. Sales | 93,220 | 5.489 | 2.663 | 0.001 | 18.422 |
| Log. Net PPE | 93,176 | 4.014 | 2.836 | 0.000 | 18.148 |
| Unemployment Rate | 71,140 | 7.538 | 3.076 | 2.245 | 27.500 |
| Real GDP Growth | 71,140 | 1.678 | 2.283 | −9.179 | 7.070 |
| Trade Union Density | 70,014 | 31.292 | 19.840 | 7.548 | 86.621 |
| Weighted Tariff Cut | 93,220 | 0.063 | 0.484 | 0 | 40 |
| Wage Bargaining Centralization | 73,950 | 0.326 | 0.180 | 0.083 | 0.925 |
| Wage Bargaining Coverage | 51,105 | 59.068 | 23.489 | 0.000 | 98.000 |
| Left Government Cabinet Seats | 71,140 | 49.185 | 42.305 | 0.000 | 100.000 |
| Social Expendture (Per. GDP) | 71,140 | 15.025 | 2.608 | 9.178 | 21.300 |
| Public Expenditures (Perc. GDP) | 71,140 | 46.943 | 5.990 | 30.937 | 63.528 |

First part of the table lists variables that are used in the main analysis, the second part those that are only employed in various robustness checks.

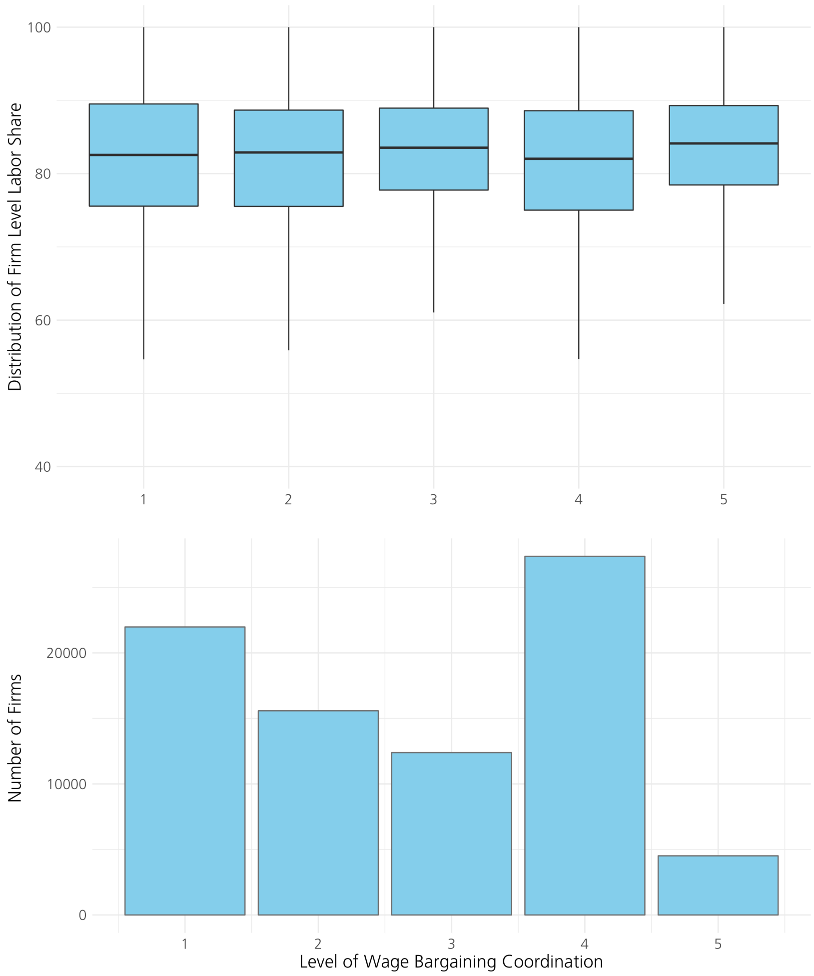


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FIGURE 2.B.2: Distribution of Firm-Level Labor Shares and Number of publicly listed Firm-Year Observations across different Levels of Wage Bargaining Coordination.

## 2.C Full Models & Robustness

### 2.C.1 Full Models

Table 2.C.2: The Effect of De Jure Trade Libearlization on Firm-Level Labor Shares - Full Model

| | *Dependent variable:* | | | |
|---|---|---|---|---|
| | Firm Level Labor Share | | | |
| | (1) | (2) | (3) | (4) |
| Tariff Cut | 0.131 | 0.082 | −0.040 | 0.019 |
| | (0.090) | (0.060) | (0.034) | (0.018) |
| Coordination | −0.506** | −0.514** | 0.273* | 0.284* |
| | (0.174) | (0.177) | (0.117) | (0.117) |
| Log. Sales | 3.941*** | 3.941*** | 5.745*** | 5.747*** |
| | (0.522) | (0.522) | (0.498) | (0.498) |
| Net. PPE Value | −1.470*** | −1.470*** | −4.285*** | −4.285*** |
| | (0.405) | (0.405) | (0.387) | (0.387) |
| Unemployment Rate | −0.092* | −0.092* | −0.179*** | −0.178*** |
| | (0.041) | (0.041) | (0.040) | (0.040) |
| Real GDP Growth | −0.249** | −0.248** | −0.084* | −0.083* |
| | (0.078) | (0.077) | (0.032) | (0.032) |
| Union Density | −0.056*** | −0.056*** | 0.219*** | 0.221*** |
| | (0.009) | (0.009) | (0.059) | (0.059) |
| Real Interest | 0.403*** | 0.405*** | 0.164* | 0.162* |
| | (0.083) | (0.083) | (0.070) | (0.070) |
| Tariff Cut x Coordination | | 0.043 | | −0.051** |
| | | (0.048) | | (0.016) |
| Year Fixed Effets | ✓ | ✓ | ✓ | ✓ |
| Firm Fixed Effects | × | × | ✓ | ✓ |
| Observations | 65,565 | 65,565 | 65,565 | 65,565 |
| $R^2$ | 0.245 | 0.245 | 0.783 | 0.783 |

*Note:* *p<0.05; **p<0.01; ***p<0.001

Models correspond to models (1) to (4) in Table 1 of the main analysis. All standard errors are clustered at the industry level (level of treatment assignment).

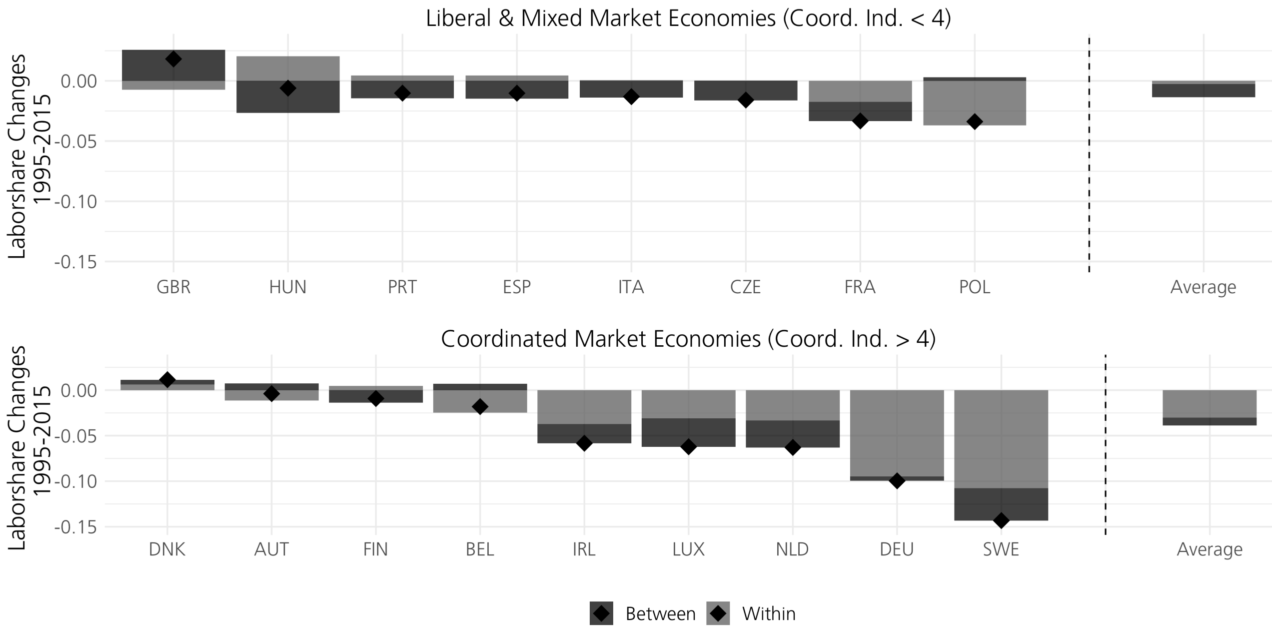


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FIGURE 2.B.3: Each bar represents the cumulated sum of a shift-share decomposition of labor share dynamics in publicly listed firms over adjacent five-year intervals between 1995-2015.

Table 2.C.3: The Effect of Import Growth on Firm-Level Labor Shares - Full Model

| | *Dependent variable:* | | | |
|---|---|---|---|---|
| | Firm Level Labor Share | | | |
| | OLS 1 | OLS 2 | OLS 3 | IV |
| Log Exp. Growth | 0.22 | 0.33 | −0.05 | 0.55 |
| | (0.49) | (0.51) | (0.21) | (1.40) |
| Coordination | −0.50** | −0.48** | 0.28* | 0.60** |
| | (0.17) | (0.17) | (0.12) | (0.22) |
| Log. Sales | 3.96*** | 3.96*** | 5.74*** | 5.75*** |
| | (0.52) | (0.52) | (0.50) | (0.50) |
| Net. PPE Value | −1.49*** | −1.49*** | −4.28*** | −4.27*** |
| | (0.40) | (0.40) | (0.39) | (0.39) |
| Real Interest | 0.41*** | 0.41*** | 0.16* | 0.16* |
| | (0.08) | (0.09) | (0.07) | (0.07) |
| Unemployment Rate | −0.09* | −0.09* | −0.18*** | −0.17*** |
| | (0.04) | (0.04) | (0.04) | (0.04) |
| Real GDP Growth | −0.25** | −0.25** | −0.08** | −0.08* |
| | (0.08) | (0.08) | (0.03) | (0.03) |
| Union Density | −0.06*** | −0.06*** | 0.22*** | 0.20*** |
| | (0.01) | (0.01) | (0.06) | (0.06) |
| Log Exp. Growth x Coordination | | −0.07 | −0.02 | −2.02** |
| | | (0.09) | (0.10) | (0.74) |
| Year Fixed Effets | ✓ | ✓ | ✓ | ✓ |
| Firm Fixed Effects | × | × | ✓ | ✓ |
| Observations | 65,565 | 65,565 | 65,565 | 65,565 |
| $R^2$ | 0.24 | 0.24 | 0.78 | 0.78 |
| K-P weak identification test (F) | | | | 31.43 |

$^{***}p < 0.001$, $^{**}p < 0.01$, $^{*}p < 0.05$

Models correspond to models (1) to (4) in Table 2 of the main analysis. Coordination measures the level of wage bargaining coordination. All standard errors are clustered at the industry level (level of treatment assignment).

### 2.C.2 Robustness

TABLE 2.C.4: De Jure Trade Libearlization on Firm-Level Labor Shares - Robustness Tests

| | *Dependent variable:* | | | |
|---|---|---|---|---|
| | Firm Level Labor Share | | | |
| | (1) | (2) | (3) | (4) |
| Tariff Cut | 0.006 | 0.002 | | |
| | (0.028) | (0.027) | | |
| Weighted Tariff Cut | | | 0.019 | |
| | | | (0.045) | |
| Export Tariff Cut | | | | 0.002 |
| | | | | (0.001) |
| Coordination | 0.807*** | 0.792*** | 0.799*** | 0.792*** |
| | (0.124) | (0.121) | (0.124) | (0.124) |
| Lagged Labor Share | | 0.141*** | | |
| | | (0.010) | | |
| Tariff Cut x Coordination | −0.058** | −0.051** | | |
| | (0.019) | (0.018) | | |
| Weighted Tariff Cut x Coordination | | | −0.143** | |
| | | | (0.053) | |
| Export Tariff Cut x Coordination | | | | −0.0004 |
| | | | | (0.002) |
| Controls | ✓ | ✓ | ✓ | ✓ |
| Year Fixed Effects | × | ✓ | ✓ | ✓ |
| Linear Time Trend | ✓ | × | × | × |
| Firm Fixed Effects | ✓ | ✓ | ✓ | ✓ |
| Observations | 64,097 | 64,096 | 64,097 | 64,097 |
| $R^2$ | 0.754 | 0.763 | 0.754 | 0.754 |
| *Note:* | *p<0.05; **p<0.01; ***p<0.001 | | | |

Coordination measures the level of wage bargaining coordination. Weighted Tariff Cut introduces an alternative measure of trade liberalization by weighting tariff cuts by the value of product-level imports from the PTA partner into the EU. Export Tariff Cuts measures the reductions of tariff that EU exporters in partner markets and serves as a placebo test. All standard errors are clustered at the industry level (level of treatment assignment).

Additional Interaction Terms

A legitimate concern regarding the interpretation of the main findings in the paper would be that the measures of market coordination could pick up the effects of other country characteristics that are often associated with coordinated market economies and which are actually driving the differences in the way in which trade liberalization affects firm level labor shares. To mitigate this concern, I include interaction terms between Tariff Cuts and and a number of alternative country-level characteristics, which might be associated with labor shares, into the main analysis I test for the following potential confounders.

- **Trade Union Density** A number of studies have found that larger and more powerful trade unions positively influence labor shares (e.g. Kristal, 2013; Bental and Demougin, 2010). I thus include trade union density as a classical measure of trade union power into the analysis. The variable measures net union membership as a proportion wage and salary earners in employment (Armingeon et al., 2017).

- **Left Government** Government policies can affect wage shares through numerous channels (e.g. Blanchard and Giavazzi, 2003; Kristal, 2010; Dünhaupt, 2013). I there for control for an interaction term between tariff cuts and the percentage of cabinet posts of social democratic and other left parties in percentage of total cabinet posts, weighted by the number of days in office in a given year (Armingeon et al., 2017).

- **Unemployment Support and Active Labor Market Programmes** Employees willingness to engage in wage restraint might also depend on the material costs of unemployment and potential support for relocation into other industries or sectors. To cover the former, I include a variable that measures social security transfers as a percentage of GDP (OECD, 2016). For the latter, I include a measure of public and mandatory private expenditure on active labor market programmes as a percentage of GDP (OECD, 2016)..

As table C.5 shows, interacting these possible confounders with trade liberalization does not yield any significant results and does not affect the main interaction term of interest. The magnitude of the main effect does not shrink and even increase in some model specification.

Table 2.C.5: Additional Interactions between Country Characteristics and Tariff Cuts

| | *Dependent variable:* | | | |
|---|---|---|---|---|
| | Firm Level Labor Share | | | |
| | (1) | (2) | (3) | (4) |
| Tariff Cut | 0.016 | −0.007 | −0.004 | 0.032 |
| | (0.068) | (0.052) | (0.118) | (0.033) |
| Trade Union Density | $0.174^{***}$ | | | |
| | (0.063) | | | |
| Left Government | | $-0.005^{***}$ | | |
| | | (0.002) | | |
| Social Expenditure (% GDP) | | | $0.358^{**}$ | |
| | | | (0.140) | |
| Active Labor Market Programmes (% GDP) | | | | $1.411^{**}$ |
| | | | | (0.614) |
| Coordination | $0.331^{***}$ | $0.303^{**}$ | $0.284^{**}$ | $0.440^{***}$ |
| | (0.119) | (0.120) | (0.113) | (0.114) |
| Tariff Cut x TU Density | 0.0003 | | | |
| | (0.002) | | | |
| Tariff Cut x Left Government | | 0.001 | | |
| | | (0.001) | | |
| Tariff Cut x Soc. Expenditure | | | 0.004 | |
| | | | (0.009) | |
| Tariff Cut x ALM Programmes | | | | 0.045 |
| | | | | (0.073) |
| Tariff Cut x Coordination | $-0.050^{***}$ | $-0.049^{**}$ | $-0.062^{***}$ | $-0.063^{***}$ |
| | (0.018) | (0.020) | (0.021) | (0.023) |
| Year Fixed Effects | ✓ | ✓ | ✓ | ✓ |
| Firm Fixed Effects | ✓ | ✓ | ✓ | ✓ |
| Observations | 64,097 | 64,205 | 64,205 | 57,160 |
| $R^2$ | 0.764 | 0.764 | 0.764 | 0.765 |

*Note:* $^{*}$p<0.1; $^{**}$p<0.05; $^{***}$p<0.01

Coordination measures the level of wage bargaining coordination. Firm-level controls include the logged value of total sales and the capital stock (measured as the overall value of all property, plant and equipment). Country-level controls include real GDP growth, unemployment rate and real interest rates. All standard errors are clustered at the industry level.

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## 2.D Additional Measures of Market Coordination

- **Labor market regulation** is constructed as an additive index of two variables. The first measures the strictness of the regulation of individual dismissal of employees on regular/indefinite contracts. The second measures the strictness of similar regulations for fixed-term and temporary work agency contracts. Both indicators are based on measures of legislation as well as enforcement processes and range on a scale from 0 to 6 with higher values indicating stricter employment protection (Armingeon et al., 2017).

- **Wage bargaining centralization** index combines a measure of the level of bargaining (centralized, intermediate, and decentralized) with a measure of union concentration. The index also takes into account the degree of enforceability of wage agreements (i.e., the ability of lower-level bargainers to elude the agreement). The index ranges from 0 to 1, where 1 corresponds to full centralization. (Visser, 2015).

- **Bargaining coverage** measures the number of employees covered by wage bargaining agreements as a proportion of all wage and salary earners in employment with the right to bargain. The measure is, thus, constructed as percentages and is adjusted for the possibility that some sectors or occupations are excluded from the right to bargain (Visser, 2015).

TABLE 2.D.6: Alternative Measures of Market Coordination - De Jure Tariff Cuts

| | *Dependent variable:* | | |
|---|---|---|---|
| | Firm Level Labor Share | | |
| | (1) | (2) | (3) |
| Tariff Cut | 0.055 | 0.048 | 0.220$^{*}$ |
| | (0.029) | (0.027) | (0.094) |
| Labor Market Regulation | −3.079$^{***}$ | | |
| | (0.358) | | |
| Bargaining Centralization | | −0.179$^{***}$ | |
| | | (0.027) | |
| Bargaining Coverage | | | −0.032 |
| | | | (0.018) |
| Tariff Cut x LM Regulation | −0.022$^{*}$ | | |
| | (0.011) | | |
| Tariff Cut x Centralization | | −0.003$^{**}$ | |
| | | (0.001) | |
| Tariff Cut x Coverage | | | −0.004$^{*}$ |
| | | | (0.002) |
| Controls | ✓ | ✓ | ✓ |
| Year Fixed Effects | ✓ | ✓ | ✓ |
| Firm Fixed Effects | ✓ | ✓ | ✓ |
| Observations | 65,565 | 62,637 | 44,327 |
| $R^2$ | 0.766 | 0.763 | 0.776 |
| *Note:* | $^{*}$p<0.05; $^{**}$p<0.01; $^{***}$p<0.001 | | |

Firm-level controls include the logged value of total sales and the capital stock (measured as the overall value of all property, plant and equipment). Country-level controls include real GDP growth, unemployment rate and real interest rates. All standard errors are clustered at the industry level.

Table 2.D.7: Alternative Measures of Market Coordination - Import Growth

| | *Dependent variable:* | | | | | |
|---|---|---|---|---|---|---|
| | Firm Level Labor Share | | | | | |
| | OLS | IV | OLS | IV | OLS | IV |
| Log Import Growth | 0.31 | 2.52 | 0.01 | 2.81 | 0.94 | 10.20* |
| | (0.38) | (1.29) | (0.36) | (1.89) | (0.68) | (4.71) |
| Labor Market Regulation | −3.08*** | −2.77*** | | | | |
| | (0.35) | (0.48) | | | | |
| Log Import Growth x LM Regulation | −0.08 | −0.96* | | | | |
| | (0.08) | (0.49) | | | | |
| Bargaining Centralization | | | −17.99*** | −14.56*** | | |
| | | | (2.69) | (3.16) | | |
| Log Import Growth x Centralization | | | −0.05 | −15.16* | | |
| | | | 0.98 | (7.32) | | |
| Bargaining Coverage | | | | | −0.03 | −0.01 |
| | | | | | (0.02) | (0.02) |
| Log Import Growth x Coverage | | | | | −0.02 | −0.14* |
| | | | | | (0.01) | (0.06) |
| Controls | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Firm Fixed Effects | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Year Fixed Effects | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Num. obs. | 65565 | 65673 | 62637 | 62637 | 44327 | 44327 |
| $R^2$ | 0.77 | 0.76 | 0.76 | 0.76 | 0.78 | 0.77 |
| K-P weak identification test (F) | | 23.99 | | 19.87 | | 42.64 |

$^{***}p < 0.001$, $^{**}p < 0.01$, $^{*}p < 0.05$

Firm-level controls include the logged value of total sales and the capital stock (measured as the overall value of all property, plant and equipment). Country-level controls include real GDP growth, unemployment rate and real interest rates. All standard errors are clustered at the industry level.

# Chapter 3

# The Politics of Stashing Wealth

## The Demise of Labour Power and the Global Rise of Corporate Savings


**Abstract**

The distribution of the benefits of growth between capital and labour is a central issue in political economy. Lately, this distribution has changed as firms throughout advanced economies have started to accumulate large savings. Instead of using their revenues to reinvest or raise wages, many firms now stash their profits on financial markets. This contributes to rising inequality, sluggish growth and financial fragilities. What explains this trend? I argue that political institutions that determine the balance-of-power between firms and employees play an important role. The stronger unions are, the more they will pressure firms into using revenues for wage raises and investment. The more their influence erodes, the stronger the rise of savings. Using panel data from 24 OECD countries and a regression discontinuity leveraging the German law on co-determination, I find robust evidence supporting this claim. The political distribution of power between employers and employees significantly shapes global macroeconomic outcomes.



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## 3.1 Introduction

In January 2017, news outlets reported that the US tech giant Apple was sitting on $246 billion of cash (Wang, 2017). Rather than using its profits to expand its business, to increase payouts to shareholders or to raise the wages of its workers, the company had accumulated savings that surpass the Gross Domestic Product (GDP) of a country like Finland. In the US, these and similar reports about other companies sparked heated debates over appropriate tax policy responses and the political issue of excessive corporate wealth (The Economist, 2016*a*; Summers, 2016). But while the corporate rivers of riches in the tech industry are especially strong, they do fit well into a broader trend. In many developed countries, firms in recent years have turned into a net lender to the rest of the economy (Chen, Karabarbounis and Neiman, 2017; Karabarbounis and Neiman, 2012).

Economically, this is a puzzling development. Since companies should take idle resources and put them into productive use, economists expect corporations to use the savings of other sectors (e.g. private households) to fund operations and finance investments (Gruber and Kamin, 2015). The recent turn towards corporate saving therefore has gained substantial attention from economists and the global financial press (Armenter, 2012; Wolf, 2015). More importantly, it also has crucial political implications.

First, corporate savings are a main driver behind the global macroeconomic imbalances that were at the heart of the Great Recession and the Eurocrisis (Gruber and Kamin, 2015; Pozsar, 2013; Duchin et al., 2017). While companies across the world have stopped investing and started to stash profits on financial markets, the trend was especially pronounced in countries like Germany and Japan, where firm savings have become a key reason for capital exports and current account surpluses. In Europe, debates about these surpluses have dominated much of the politics of the Eurocrisis (Frieden and Walter, 2017). At the international level, they have turned into an important justification for the reemergence of protectionism and trade conflicts (Irwin, 2016).

Second, the rise of corporate savings fuels economic inequality. As more and more firms retain their revenues and park them on financial markets, less and less of their profits find their way back into the real economy. While this leads to rising booming asset prices, the flip sides of this trend are lower investment rates and decreased demand for labor. Income generated from firm savings falls mostly on the side of capital (Brufman, 2013; Piketty, 2014). For workers they mean less jobs and lower wage growth. As Karabarbounis and Neiman (2012) point out, as the share of firm savings in total global savings in recent years increased by more than 20 percent, this increase was associated with a 5 percent drop in the share of national income that was paid to workers and employees. This falling labor share is directly linked to several measures of income inequality (Checchi and García-Ieñalosa, 2010). Explaining what shapes the global trend towards higher corporate savings thus constitutes and important and often overlooked aspect of our understanding of rising inequality and its effects on democratic politics, voter preferences and political inequality (Dahl, 1986; Bartels, 2016).

Economic research so far ascribes the trend towards large firm savings mostly to structural factors such as technological advances and demographic change (Chen, Karabarbounis and Neiman, 2017; Gruber and Kamin, 2015). It offers valuable insights in the macro-trends underlying this development. However, this paper argues that focusing solely on economics provides and incomplete account of the rise of corporate savings. Political institutions play a key role in mitigating this trend. A vast literature within political science documents the secular decline in the political power of organized labor and its impact on wage inequality (e.g. Ahlquist and Answell, 2017; Scheve and Stasavage, 2009; Rueda and Pontusson, 2000), democratic politics and partisan politics (e.g. Becher, Stegmueller and Käppner, 2018; Mosimann and Pontusson, 2017; Rosenfeld, 2014) as well as trade politics and market regulation more generally (e.g. Mosley and Singer, 2015; Dean, 2015). Building on these insights, I argue that the demising organizational power of labor also helps explaining the rise of corporate savings. Whereas economic insecurity and the deregulation of financial markets have made it attractive for firm owners and managers to retain profits and stash them in financial assets, this strategy comes at considerable opportunity costs for workers, who would prefer the fruits of their labor to be used for employee expenses and productive investment. Savings are thus subject to distributional conflict between capital and labor. Their emergence depend on political institutions that determine the balance-of-power between the two actors. The larger labor's political profit-sharing capacities are, the more they will pressure firms into using revenues for wage raises and investment. The more their in influence erodes, the larger the rise of savings.

I employ two strategies that provide evidence in line with this argument. As a first descriptive test, I analyze panel data from 25 OECD countries over 19 years. I show that there is a robust negative relation between corporate savings and trade union density at the country level. The larger the share of organized workers in an economy, the lower the savings rate of the corporate sector. Second, I move my analysis to the firm level and exploit a natural experiment provided by the German law on co-determination. The law mandates firms with more than 2000 domestic employees to occupy half of their supervisory boards with employee representatives. As these boards not only monitor investment decisions and strategic business choices but also directly appoint the firm's management board, parity co-determination renders workers with considerable power resources. Using the discontinuity around the mandated threshold , I am able to causally identify the effect of increased labor influence on corporate savings. I find that labor power in the form of co-determination significantly decreases savings. On average, firms with parity co-determination accumulate more than US$46 Million (or about 4.3% of total assets) less in cash and short-term investments than similar companies without such institutions.

Besides adding to our understanding of the political economy of large corporate savings, this paper makes two broader theoretical contributions. First, it adds to a growing literature within international political economy which analyses the domestic sources of global imbalances (e.g. Ahlquist, 2010; Baccaro and Pontusson, 2016). By showing that the demise of labor power in some countries has contributed significantly to the rise of corporate savings, the paper helps to explain an important driver of global balance-of-payments imbalances and financial fragilities. Second, it contributes to the literature on the effects of declining labor power and trade unionism. By showing that the rise of corporate savings can be causally linked to a decline in labor's politically-backed ability to push for profit-sharing, the paper illustrates the political power of labor has become an important determinant of to what degree the revenues of private firms are spent in ways that stipulate growth and employment.

### 3.2 The Global Rise and National Variation of Corporate Savings

Corporate savings are defined as the excess of revenues over debts, investment and payouts. Savings are thus retained profits which are held in the form of cash and other financial assets (Gruber and Kamin, 2016). In recent years, these savings have experienced a dramatic rise. Global corporate saving has increased from below 10% of global GDP in the 1980s to almost 15% in the 2010s. This is especially puzzling as building up savings is not what economic theory expects firms to do. Instead, surplus revenues should be reinvested to increases productivity, they should be used to raise employee remuneration or they should be distributed to shareholders (Blanchard, Rhee and Summers, 1993). To explain this trend, research so far has focused on structural factors such as technological advances which push down the prices of investment goods and increase corporate profits (Karabarbounis and Neiman, 2012), strengthened precautionary saving motives[1] due to the financial crises of the late 1990s and 2000s (Sánchez, Yurdagul and S, 2013) and a protracted decline in the investment incentives of private firms due to lower interest rates and other factors linked to the "secular stagnation" hypothesis (Summers, 2014).

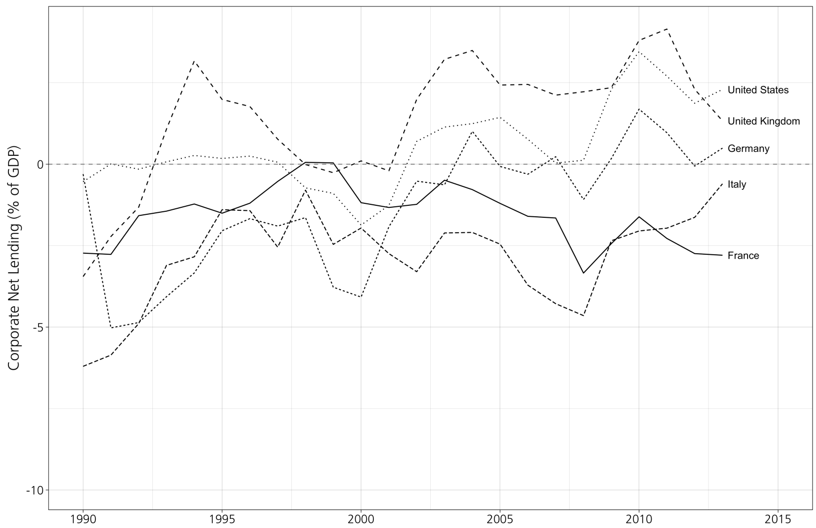



FIGURE 3.1: Development of Corporate Savings in Major Economies; Data based on Chen, Karabarbounis and Neiman (2017).

However, as Figure 3.1 illustrates the trend towards higher savings has varied considerably across countries. In some countries, like the US and the UK, non-financial corporations (NFCs) have been net lenders to the economy since the early 2000s. The lending position of the German corporate sector, on the other hand, has only recently turned positive and in countries like France or Italy the corporate sector remains a net-borrowers until today. The

[1]Precautionary savings motives also play an important role for research within the field of corporate finance which analyses firm-level motives for savings and cash holdings (Lins, Servaes and Tufano, 2010). Other important determinants from this literature include CEO compensation schemes (Liu and Mauer, 2011) as well as strategic motives in wage negotiations with employees (Matsa, 2010).

e national contexts in which firms operate, thus, seem to play an important role in mitigating this trend. Against this background, this paper analyses the role of political institutions in shaping the trend towards higher corporate savings.

### 3.3 Corporate Savings and Profit Sharing Capacities

To explain the rise of corporate savings, I focus on its distributional implications. While for managers and large owners, it has become beneficial to retain profits and park them on financial markets, this strategy comes at significant opportunity costs for workers. Given these distributional implications, I argue that political institutions, which increase workers' profit-sharing capacities counteracts the rise of corporate savings. The more such institutions erode, the stronger savings surge.

It is important to point out that while this paper thus focuses on distributional conflicts along class lines (Gourevitch and Shinn, 2007), conflicts about savings may also arise between managers and different types of owners. Especially, small shareholders should push towards the distribution of surplus profits since they cannot monitor firms' executives closely enough to make sure they do not use them for their private benefits (La Porta et al., 2000). However, in most developed countries, firms are still owned by a few large owners, which can directly influence the decisions of executives and whose savings motives are therefore aligned with those of managers (e.g. Anderson and Hamadi, 2009). Also, dividend payments have remained relatively stable since the 1990s (Gruber and Kamin, 2016) and changes in the ownership structures have mainly lead to a greater dispersion of ownership (Krippner, 2005). If anything, this should have lead to lower savings. I thus focus my theory on class cleavages and account for the role of shareholders empirically.

The Distributional Implications of Large Corporate Savings

There are four ways in which surplus revenues can be used: raising wages, paying dividends to shareholders, increasing investment or building up savings. For management and controlling owners, raising wages provides the least preferred strategy (Gourevitch and Shinn, 2007). While the second option - increasing dividends - is preferable to higher wages, distributing profits also comes at the cost of losing access to valuable resources. A large literature within corporate finance shows that it needs a whole battery of minority shareholder rights to pressure firm insiders into handing out profits to outside owners (e.g. La Porta et al., 2000). This leaves management and controlling owners with two options: retaining profits or reinvesting them. The attractiveness of savings has increased for at least three reasons.

First, large savings ensure flexibility. Especially if investment opportunities in the current environment are perceived to be limited, saving today's profits helps financing future investments irrespective of possible credit constraints (Gruber and Kamin, 2016). Second, even if the economy is doing well, large amounts of savings provide opportunities to realize profits on financial markets. Since the 1990s, non-financial firms in many advanced economies increasingly rely on income from financial investments (Krippner, 2005; Crotty, 2005). The liberalization of capital accounts, the deregulation of financial markets and the expansion of financial instruments have made it lucrative for firms to retain parts of their profits and stash them in short-term, reversible assets which maximize yields without bearing the risks of fixed capital investments (Duchin et al., 2017). Finally corporate savings also have come to produce direct gains for executives. In many firms, a large share of executive compensation today is tied to the company's stock value (Krippner, 2011). Corporate savings benefit these values in two ways. First, financial investors in many sectors place a high value on savings (Pinkowitz and Williamson, 2007). The higher the savings stashed inside a firm, the higher the value of its share. Second, savings are often used for share buybacks. By buying back stocks - which, as the investment does not leave the firm, accounting-wise counts as savings - executives can push the market value of their shares and boost their compensation (Gruber and Kamin, 2016).

Accumulating savings has become increasingly attractive for management and controlling owners. This is, however, not the case for workers. First, labor's preferred way of using surpluses should be to increase wages. Higher salaries are the most direct way in which workers can benefit from profits. Assuming that workers want to maximize their income, employees of firms with substantial surpluses should first and foremost push to increase wages (Ahlquist, 2010). If higher wages cannot be achieved, increasing investment renders an attractive alternative.[2] On the one hand, real investments in productive assets and worker training directly foster workers' job security. On the other hand, productivity increases also

[2]While I assume that workers favor wages over investment, this ordering could also depend on the specific status of workers. For example, long-term employees with firm-specific skills might prefer investments over the short-term gains of higher wages. However, this does not change the empirical implications of my arguments.

imply better prospects for future wage gains (Gourevitch and Shinn, 2007). For workers, corporate savings, thus, matter most for what they are not. While they might be preferable to distributing profits to outsiders, the accumulation of savings can only be be achieved at the expense of forgone wage raises and stagnant or reduced investments. At the same time, retaining profits in financial assets may increase the stock market value of a firm and help to realize short-term gains. Workers, however, have little opportunities to participates in these forms of profit generation (Akkemik and Özen, 2014).[3] Stashing profits thus hurts the direct material interests of employees. As a representative of one of the biggest trade unions in Germany put it in a personal interview: ”If firms now are able to build-up these huge savings, this simply means that we have failed in fighting for our share of the pie.”[4]

### Corporate Savings and Profit Sharing Capacities

Put simply, firms have little to loose and much to gain from retaining their profits, whereas for workers, these savings come at considerable costs. Given these distributional implications, I expect savings to be subject to conflicts between management and labor and the outcomes of these conflicts to be shaped by the balance of power between the two actors. This balance is to a large degree shaped by economic factors such as the labor market situation, the skill endowment of workers and their position in the production process (Dean, 2015). However, most research assumes employers to enjoy a natural advantage in conflicts with labor - either due to their smaller numbers, lager material resources and their ownership of means of production (Olson, 1965; Acemoglu and Robinson, 2008) or due to the simple fact that workers must work to live (Polanyi, 1944).

To influence the distribution of profits, workers therefore rely on political context factors. Building on Dean’s (2015) recent work on profit-sharing institutions, I call these factors the *profit-sharing capacities* of labor. Dean defines profit-sharing institutions as ”a set of rules that govern wage negotiations and create a credible link between an increase in profits and an increase in workers wage” (p.32 Dean, 2015). However, not all of labor’s profit-sharing capacities are rooted in institutions in a strict sense and while rising salaries are a top concern

[3]This distinction is less clear for companies with employee-ownership plans or stock options. However, in most OECD countries these plans remain a niche phenomenon and most prevalent among financial firms (Lowitzsch and Hashi, 2014).

[4]Representatives of German trade unions (DGB and verdi) confirmed this view in independent interviews that I conducted in Berlin in December 2017.

for most employees, research has shown that employment security often ranks equally high (e.g. Johnston, Hancké and Pant, 2014). Here, I therefore define profit-sharing capacities as institutions, rules and organizational environments that strengthen the link between capital's profits and worker's welfare - either in the form of higher wages or due to better employment prospects through productive investments.

Two factors determine the strength of such capacities. First, literature rooted in power resource theory stresses the importance of associational power (Korpi and Palme, 2003; Bradley et al., 2003). The more workers are able to organize and to control the supply of labor into certain firms or industries, the better they are able to push through their preferences (Ahlquist, 2010; Rosenfeld, 2014). Power resource theory therefore emphasizes the strength of trade unionism as a core determinant of labor power (Volscho and Kelly, 2012). Second, research on corporatism focuses on legal power resources such as institutionalized labor rights - form shop-floor representation to labors' presence in macroeconomic corporatist institutions (Streeck and Thelen, 2005) -, which equip labor representatives with direct leverage in cases of conflicts with employers (Martin and Swank, 2004). My theoretical argument remains largely agnostic about the specific sources of profit-sharing capacities. Both institutionalized labor rights and associational power provide workers with an audible voice in decisions over the usage of profits. The louder this voice, the more difficult it is for management and owners to retain profits and the more likely it becomes that labor successfully pushes towards using surplus revenues for higher wages and investment. Shifts in the balance of power between capital and labor should directly influence the saving behavior of the corporate sector. The more influence labor has on determining where profits flow, the lower the level of corporate savings.

Summing up, I argue that corporate savings are the result of concrete distributional conflicts between management and labor and that their emergence is shaped by worker's profit-sharing capacities. The better the political contexts equip labor to push through its interests, the lower I expect corporate savings to be.

## 3.4 Analysis

### 3.4.1 Research Design

I investigate this argument in two steps. First, I use panel data on 25 OECD countries over 19 years to analyze the relationship between country-level corporate savings and trade union density as the most straight-forward proxy for the strength of profit-sharing capacities. I find that higher levels of trade union density are strongly associated with lower levels of corporate savings. Second, I complement the cross-country analysis with a case study on publicly listed firms in Germany. I exploit a natural experiment provided by the setting of the German law on co-determination which mandates firms with more than 2000 employees to occupy one half of their supervisory boards with employee representatives. Using the discontinuity around this mandated threshold, I am able to causally identify the expected negative effect of increased labor power on corporate savings.

### 3.4.2 Cross-Country Analysis - Trade Union Density & Corporate Saving

Dependent Variable

For the cross-country analysis, I assemble a dataset on 25 OECD countries between 1995 and 2013. My main variable of interest is corporate saving at the country level, which is defined as the excess of gross savings of all firms in an economy over their aggregated investment spending. The variable measures all savings (that is profits after taxes, interest payments, dividends etc. minus capital investment) - irrespective of whether they are held in cash, cash equivalents or other financial assets - as a percentage of GDP. Data is taken from Chen, Karabarbounis and Neiman (2017), who collected it based on national-accounts information.[5] As the savings of banks and other financial firms follow different logics than non-financial firms, I only analyze the non-financial sector. Furthermore, I focus on OECD countries. Advanced economies have been the main driver of increased corporate savings, they traditionally have the most established forms of profit-sharing capacities and they offer the best data quality. Finally, national-accounts data remains scattered for earlier time periods. To balance my panel, I thus focus on the period between 1995 and 2013. Since the main changes in the corporate savings trends occurred in the late 1990s and early 2000s, this

[5] I arrive at my final measure for savings by subtracting gross fixed capital formation (item GFCF) form the gross savings (item GS)

should not constrain the validity of the analysis.[6] Details of the variable construction and its development across countries can be found in the appendix (p.1).

Independent Variables and Controls

My argument suggests that rising savings reflect a decrease in labor's profit-sharing capacities. To compare these capacities cross-nationally, I operationalize profit-sharing capacities as trade-union power and measure it using *trade union density* (Baccaro and Howell, 2011). Union density measures the proportion of wage earners that is organized in trade unions. While it mainly captures the associational dimension of profit-sharing capacities, it is a useful proxy for trade-unions' overall ability to mobilize, pose strike threats and to build up pressure in negotiations with management (Witko, 2016). Importantly, whereas other measures of labor power such as union concentration mainly capture labor's political power - e.g. the ability to jointly mobilize in favor or against specific policies (Owen, 2015) - trade union density comes closest to measuring economic power vis-a-vis employers.[7] To test for robustness, I replicate my analyses with collective bargaining coverage as a complementary measure of labor power (Thelen, 2012). Table A.3 in the appendix (p.6) shows that the results remain substantially the same.

To control for the macroeconomic environment, I include *real GDP growth* and the annual *real interest rate*. One problem with the national accounts data is that profits that are invested abroad still show up as domestic savings. To make sure that I analyze actual savings, I therefore control for annual *FDI outflows* (% of GDP). I also include a *crisis dummy* for the years 2007 and 2008 ,which I expect to have a negative impact on corporate savings. *Technological change* has been proposed as a key explanation for rising savings. As technological advances make capital goods cheaper, firms substitute machines for labor leading to an increased capital share and higher savings. To control for technological change, I use the share of routine task employment (Autor, Levy and Murnane, 2003; Owen and

[6]Furthermore, as outlined above the factors that made savings an increasingly attractive strategy for management (capital account liberalization, financial deregulation and innovation, changes in the structure of executive etc.) mainly occurred from the 1990s onwards. My argument would therefore not necessarily expect differences in profit sharing institutions to have similar effects in earlier periods.

[7]These aspects also provide a distinct advantage over other measures of trade union power such as union centralization and wage coordination. Both of these variables capture the degree to which trade unions are able to extend their influence beyond the single firm or industries and to coordinate wage raises across different sectors. Whereas they are informative when it comes to the influence of trade unions at the macro-level, trade union density provides a more useful proxy for union's ability to affect saving decisions at the *firm-level*.

Johnston, 2017) [8] by weighting employment in each occupational category per year as a percentage of total employment by its routine task intensity score (Meyer, 2017). The lower its value, the more technology intensive the economy and the higher corporate savings should be. I also include the value of *stock market capitalization* as percentage of GDP and the *old-age dependency ratio*. The former is a widely used proxy for the level of financial deepening and should be negatively associated with savings. Old-age dependency ratio measures the proportion of dependents (older than 64) to working age population and should be positively associated with savings, as firms in aging societies might see fewer investment opportunities and fear future credit constraints. Last, I also add *statutory corporate income tax rates* as a final control (Chen, Karabarbounis and Neiman, 2017). The appendix lists all summary statistics and data sources (p.4).

Method

I analyze the relation between corporate savings and trade union density with a panel regression. Since the data is time-series cross-sectional the Gauss Markov assumptions of standard ordinary least squares (OLS) regression analyses are likely to be violated. Especially, test statistics reveal the presence of autocorrelation and heteroskedasticity.[9] I thus opt for a Prais-Winsten transformation and calculate panel corrected standard errors (Beck and Katz, 2011; Wilson and Butler, 2007).[10] Further test statistics show that the data is stationary.[11] To control for time-invariant, country-specific factor that may affect savings such as, for example, ownership concentration, I thus include country fixed effects(Dittmar, Mahrt-Smith and Servaes, 2003).[12] I include year-fixed effects in some specifications to control for common shocks across countries. As a robustness test , I also report a dynamic panel

[8] Technological change mainly affects tasks that can be accomplished by machines following programmed rules. Examples include manual labor such as moving a windshield into place on an assembly line but also programmable accounting and other calculating services (Autor, Levy and Murnane, 2003).

[9] More precisely, a Breusch–Godfrey test rejects the null hypothesis of no autocorrelation and Breusch-Pagan tests reject the null hypothesis of constant variance.

[10] As an alternative way to address autocorrelation, I also run dynamic models with a lagged dependent variable(Keele and Kelly, 2006).

[11] Augmented Dicker-Fully tests reject the null that the data has a unit root.

[12] A Breusch and Pagan Lagrangian multiplier test rejects the null hypothesis of no country-specific variance and a Hausman test confirms that estimating the model with fixed effects is preferable to random effects.

model including a one year lag of corporate savings as well as autoregressive distributed lag model, which additionally controls for trade union density in the previous year.[13]

Panel data on macroeconomic variables that cover many countries and years often suffer from missing values that do not occur completely at random (Lall, 2016). To address possible biases and reduced statistical power, I use multiple imputation as described in Honaker, King and Blackwell (2011). In the imputation model, I include all variables of the subsequent analysis and add a number of variables that have few missing values and that are likely to correlate with the covariates such as inflation, unemployment, capital openness, fiscal deficits and the share of high-tech exports as well as leads and lags of key variables (Honaker and King, 2010). I impute five data sets, which corresponds to the average missing-data rate of the variables in the model (Lall, 2016). I then calculate the means of the coefficients and standard errors from these five imputations. Details on the procedure and imputation diagnostics can be found in the appendix (p.2).

### Cross-Country Results and Discussion

Table 1 presents the main findings for the cross-country analysis. Model 1 shows a simple bivariate regression with country-fixed effects, Model 2-3 add the relevant controls, Model 4 additionally includes year-fixed effects.[14] As a robustness test, Model 5 and 6 add a one-year lag of the dependent variable as well as the independent variable.

As expected, trade union density consistently correlates negatively with corporate savings. The effect is statistically significant and substantially large. To pick one example, between 1995 and 2013 trade union density in Germany declined by about 12 percentage points. In the full-controls model (model 4), such a drop is associated with an increase of corporate saving by about 1,7 % of GDP (in total, Germany's corporate savings rose by about 2.5% of GDP in the same period). In this sense, almost 68% of Germany's increase in corporate savings could be associated with declining trade union density. All the controls point into the expected direction. To visualize these findings, Figure 3.2 plots the correla-

[13]The combination of country fixed effects with lagged dependent variables can result in biases (Nickell, 1981). However, given my relative long time series of almost 20 years this is less of a concern(Beck and Katz, 2011). Nonetheless, I will focus my substantial discussion on the non-dynamic models.

[14]To make sure that the effects are not driven by a general trend over time, I also included time-trend variable instead of fixed effects. This does not change the results.

Table 3.1: Higher Trade Union Density is associated with lower Corporate Savings

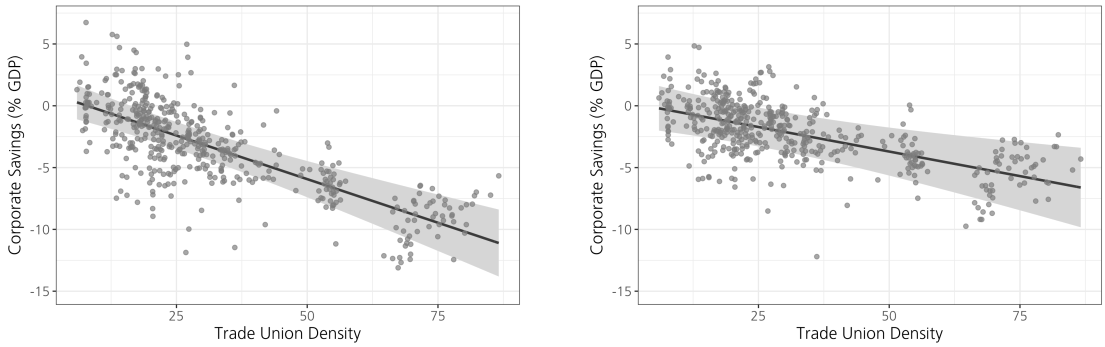
| | Dependent variable: Corporate Savings (% GDP) | | | | | |
|---|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) | (6) |
| Trade Union Density | −0.159*** | −0.207*** | −0.131*** | −0.142*** | −0.077*** | −0.100*** |
| | (0.041) | (0.033) | (0.033) | (0.032) | (0.023) | (0.024) |
| RTI Score | | −0.317* | −0.094 | 0.002 | −0.133 | −0.132 |
| | | (0.171) | (0.125) | (0.128) | (0.130) | (0.130) |
| FDI out (% GDP) | | −0.017 | −0.020* | −0.012 | 0.003 | 0.001 |
| | | (0.012) | (0.011) | (0.011) | (0.010) | (0.010) |
| Real GDP Growth | | 0.042 | 0.075* | −0.016 | 0.110*** | 0.112*** |
| | | (0.049) | (0.045) | (0.055) | (0.040) | (0.040) |
| Real Interests | | 0.123* | 0.137** | 0.121* | 0.164*** | 0.156*** |
| | | (0.063) | (0.063) | (0.067) | (0.052) | (0.052) |
| Crisis Dummy | | −0.982** | −1.095*** | | −1.204*** | −1.198*** |
| | | (0.450) | (0.414) | | (0.375) | (0.375) |
| Stock Capital. | | | 0.00005 | 0.002 | 0.001 | 0.001 |
| | | | (0.004) | (0.004) | (0.003) | (0.003) |
| Old Age Dep. | | | 0.179** | 0.178** | 0.160*** | 0.150*** |
| | | | (0.083) | (0.089) | (0.049) | (0.048) |
| Corp. Income Tax | | | −0.112*** | −0.070** | −0.091*** | −0.092*** |
| | | | (0.029) | (0.028) | (0.022) | (0.022) |
| Net Lending Lag | | | | | 0.484*** | 0.474*** |
| | | | | | (0.051) | (0.052) |
| Trade Union Density Lag | | | | | | 0.026** |
| | | | | | | (0.012) |
| Country Fixed Effects | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Year Fixe Effects | × | × | × | ✓ | × | × |
| Observations | 474 | 474 | 474 | 474 | 474 | 474 |
| $R^2$ | 0.613 | 0.656 | 0.684 | 0.712 | 0.783 | 0.785 |
| Adjusted $R^2$ | 0.591 | 0.633 | 0.660 | 0.678 | 0.766 | 0.768 |
| Residual Std. Error | 2.362 (df = 448) | 2.238 (df = 443) | 2.152 (df = 440) | 2.096 (df = 423) | 1.787 (df = 439) | 1.778 (df = 438) |
| F Statistic | 28.351*** (df = 25; 448) | 28.193*** (df = 30; 443) | 28.873*** (df = 33; 440) | 20.924*** (df = 50; 423) | 46.493*** (df = 34; 439) | 45.808*** (df = 35; 438) |

*Note:* *p<0.1; **p<0.05; ***p<0.01

tion between trade union density and corporate savings given country-fixed effects only and twoway-fixed effects and the full set of controls.

The analysis provides first evidence for a negative relationship between labor power[15] and corporate savings. The association is substantially relevant and holds for a wide range of specifications. However, the cross-national design also operates at a high level of aggregation, which makes it difficult to clearly identify the causal relation that my argument suggests. Whereas I control for the theoretically most relevant alternative explanations as well as for country- and time-specific unobservables, the development of trade union density might still be endogenous to a range of factors that I am unable to grasp in this set-up. To counter these problems and to investigate the effect of profit-sharing institutions more carefully, the next section looks at a case study on corporate governance in Germany.

[15] Robustness tests on p.6 in the appendix show that this relation also holds for bargaining coverage as an alternative measure of labor power.




(A) Country-fixed effects (Table 1 - Model 1)

(B) FE & controls (Table 1 - Model 4)

FIGURE 3.2: Corporate Savings & Trade Union Density - Partial Residual Plots

### 3.4.3 Case Study - Co-determination and Corporate Savings in Germany

I focus on Germany as a important case for the relationship between corporate savings and labor power. As pointed out in Figure 3.1, Germany was relatively late in joining the club of countries with positive savings. Ever since the mid-2000s, German companies, however, have accumulated large piles of retained profits. This savings have been one of the main drivers of the country's large current-account surplus (Brufman, 2013), they have been associated with sluggish domestic demand (**?**) and they have contributed massively to Germany's large capital exports, for which the country has widely been criticized (Obstfeld, 2012; IMF, 2014). At the same time, though Germany still has a comparatively strongly organized workforce and one of the world's most sophisticated system of labor representation (Thelen and Turner, 1999), the institutional foundations underpinning much of the countries' traditional labor strength have experienced substantial changes (Baccaro and Howell, 2011). Germany thus provides an excellent context to study the relation between labor power and corporate savings and the specificities of the German law on co-determination allow me to analyze the causal link between corporate savings and the strength of profit sharing institutions at the firm level.

#### Measuring Corporate Savings at the Firm Level

I obtain firm-level data on corporate savings from Compustat Global. The database provides the financial statements of publicly listed firms in most advanced economies since 1990. For Germany, the total dataset includes observations on 1390 individual firms and about 18500 firm-years. I again focus on the savings behavior of non-financial firms and exclude all banks and other financial institutions. Since Compustat only lists publicly listed firms, the sample is somewhat skewed towards larger companies. However, since these firms account for a large share of Germany's output, employment and productivity, they provide a good starting point for investigating the savings behavior of German companies.

The main dependent variable of interest is a firm's savings in a given year. While this variable is not readily available in Compustat, it can be calculated based on information in the balance sheets. I follow Chen, Karabarbounis and Neiman (2017) in defining net savings as the excess of savings over investment and deducing it from a range of variables available in Compustat. Details can be found in the appendix (p.7). The resulting variable measures corporate savings at the end of each company's fiscal year. One problem with this measure is that the balance sheet data only registers capital expenditures in the company's country of origin. Similar to the cross-country analysis above, some share of my measure of net saving could thus stem from lending to foreign affiliates and therefore constitute FDI rather than actual savings (IMF, 2014).

I circumvent this problem by focusing my analysis on a narrower definition of savings: cash and short term investments on financial markets. This measure is the sum of the balance sheet accounts "cash and cash equivalents" and "short-term investments"[16] It includes cash holdings in firm's deposits as well short-term financial assets such as corporate bonds, government bonds, stocks, and mortgage-backed securities. It excludes corporate savings that are used for more long-term investment on financial markets or the repayments of debt obligations. While providing me with a more conservative estimate of corporate savings, this approach should be taken with a grain of salt. There is no one-to-one relation between a firm's liquid assets and its net saving position. Firms could, for example, issue long-term debt and acquire liquid assets, which would boost their cash holdings without changing their savings positions. At the same time, not all speculative assets on financial are bound to be short-term (Duchin et al., 2017). However, the two measures are tightly correlated and in the period between 2008 and 2015 more than 60 percent of the variation in firm's net savings can be explained by their holdings of liquid financial assets. More details on the correlation between the two measures can be found in the supplementary materials (p.8).

[16]Cash and cash equivalents refer to financial assets with a maturity of up to 90 days. Short-term investments include financial assets that a firm intends to liquidate within a year.

Parity Co-determination as Randomly Assigned Profit-Sharing Power

The German Co-determination Act provides a handy case to test this claim that larger profit-sharing capacities lead to less savings. In general, companies in Germany have a two-tier board system with a management and a supervisory board. The former consists of managers and is the main body responsible for running the daily business. Members of the supervisory board, on the other hand, have the right to supervise managers, to approve major firm strategy and investment decisions and to appoint the members of the management board for at most five years, with the possibility of re-election (Section 84 (1) of the Stock Corporation Act). Their monitoring role and the fact that supervisory board members directly appoint managers provide them with powerful means to influence decision making: if they are not satisfied with a manager's performance, they can deny her re-election (Lin, Schmid and Xuan, 2018).

In general, German firms with more than 500 employees have to occupy one third of their supervisory boards with workers. However, the potency of co-determination significantly increases for larger firms. German law mandates that the supervisory boards of firms with more than 2000 employees has to consist of an equal number of owners and employee representatives. While the idea of implementing parity co-determination goes back to the early 1950s, it was only under a coalition of the Social Democratic Party (SPD) and the Free Democratic Party (FDP) in 1976 that the law was actually implemented (Kim, Maug and Schneider, 2018). According to Lopatta, Böttcher and Jaeschke (2018) the regulation aimed at expanding democratic elements into the work place by allowing workers to exert direct pressure on managers. It thus constitutes a prime example of profit-sharing capacities in the form of institutionalized labor rights. Managers in firms with parity co-determination not only have to justify their savings decisions to labor representatives, they also have to fear not to be re-elected if their strategies hurt workers' interests. While this power differs from firm to firm and is affected by institutional factors such as specific board voting rules, I assume that, everything else being equal, the jump to full fledged parity co-determination provides an significant increase of labor's profit-sharing capacities at the firm level.

To identify the causal effect of labor parity co-determination (LPC) on corporate savings, I apply a regression discontinuity design around the threshold of 2000 employees (Eggers et al., 2018; Sekhon et al., 2016). In a more formal way, German law stipulates that:

$$LPC_{i,t} = \begin{cases} 1 & if\ X_{i,t} > 2000 \\ 0 & if\ X_{i,t} \leq 2000, \end{cases} \tag{3.4.1}$$

where $i$ indicates firms, $t$ years and $X$ the number of employees. Naturally, I can never observe both potential outcomes for the same unit (i.e. the exact same firm in the same year having parity co-determination *and* not having parity co-determination). However, the arbitrary statutory threshold allows me to analyze firms that are very close to this cut-off point and that should therefore be similar on most dimensions except for their respective level of labor power (Imbens and Lemieux, 2008).[17]. The main model reads as:

$$Y_{i,t} = \alpha + \tau \cdot D_{i,t} + \beta \cdot (X_{i,t} - c) + \gamma \cdot (X_{i,t} - c) \cdot D_{i,t} + \nu \cdot \mathrm{Z}_{i,t} + \epsilon_{i,t}, \tag{3.4.2}$$

where $Y_{i,t}$ represents savings of firm $i$ at time $t$, $X_{i,t}$ is the forcing variable and denotes the number of employees in firm $i$ at time $t$, $c$ represents the mandatory threshold of 2000 employees, $D$ is a dummy that switches to one if a firm is across the threshold and $\mathrm{Z}_{i,t}$ constitutes a vector of control variables (e.g. year and industry fixed effects). The local difference between the intercepts of the regressions at both sides of the cut-off point constitutes the LATE. In the specification above, it is given by the coefficient $\tau$ of the treatment dummy $D_{i,t}$.

Identifying Assumptions

It is important to rule out two factors that could harm the set-up of the RDD design: Contamination by other treatments and sorting around the threshold. First, in order to pin down the effect of parity co-determination it is crucial that it is the *only* firm characteristic that changes at the 2000 employee threshold. I checked for a range of alternative regulations such as capital and corporate tax rates, financial disclosure rules and other corporate governance institutions. To the best of my knowledge, there are no institutionalized factors but parity co-determination that are affected by this particular threshold.

[17] Gorton and Schmid (2004) and Lin, Schmid and Xuan (2018) use a similar design to analyze the effect of co-determination on firm valuation and working capital.

Second, firms should not strategically manipulate their number of employees in order to avoid having to establish LPC. If such sorting occurred, firms would self-select into treatment and control groups and treatment assignment would not be as good as a random. Two theoretical considerations mitigate these concerns. First, Lin, Schmid and Xuan (2018) argue that keeping the number of employees artificially small would imply that both manages and owners are willing to forgo future growth. Since firms close to the 2000 employee mark know that expansion at some point will mean that they have to implement co-determination, the actually benefit of reducing growth in order to postpone this point seems relatively small. Second, the fact that I am focusing on listed firms makes strategic sorting unlikely since the interest of managers, owners and shareholders may not be aligned. Especially, shareholders should object situations in which they give up firm growth in order to manipulate the composition of supervisory boards. In line with the arguments, neither Lin, Schmid and Xuan (2018) nor Kim, Maug and Schneider (2018) find any evidence for systematic clustering around the threshold and a Government Commission set up in 2005 in order to review the law on co-determination reported ”only very few cases of companies avoiding board-level representation”. As a sorting formal test, I use a McCrary (2008) density test to investigate the distribution of employment numbers around the threshold. If firms manipulated their number of employees to circumvent co-parity determination, we should, for example, see an uptick in the number of firms with just below 2000 employees. Figure 3.3 plots the result. Visual expectation and statistical tests find no evidence for systematic clustering around the threshold (McCrary Test: p-value = 0.27).

As another indirect test of sorting, I perform a balance tests, to check that covariates which might affect firms' saving behavior are continuous at the cut-off. Table 2 shows the result of these tests for different measures of ownership concentration, sectoral composition and years for the sample. None of these firm characteristics are affected by crossing the threshold. It thus appears that business and operational considerations are the driving determinants of employment decisions for mid-sized firms.[18]

[18] To fully rule out that my findings are driven by specific violations of the identifying assumptions of RDDs, I also exploit the panel structure of the data for a difference-in-differences design and find similar effects (see robustness checks and p.12 in the appendix).

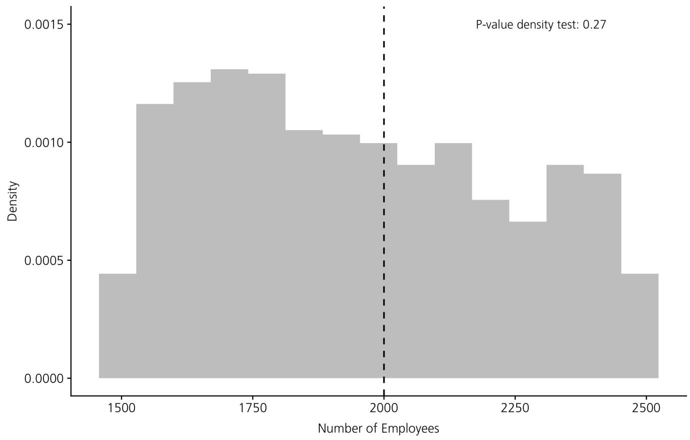



Figure 3.3: McCray (2008) density test shows that there is no jump in the density of firms around the threshold (p-value .262)

Table 3.2: Falsification tests: effect of parity co-determination on pre-treatment covariates

| RD Falsification Test - Covariate Balance | | | |
|---|---|---|---|
| | Outcome: Pre-treatment Covaraites | | |
| | Estimate | 95% CI | p-value |
| Ownership Concentration (Share Largest) | 10.436 | [−48.35, 69.21] | 0.73 |
| Ownership Concentration (Mean Share 5 Largest) | 0.829 | [−34.344, 36.00] | 0.963 |
| Single Owner Dummy | −0.043 | [−0.892, 0.805] | 0.912 |
| Manufacturing Dummy | 0.143 | [−0.221, 0.509] | 0.440 |
| Service Dummy | −0.069 | [−0.322, 0.184] | 0.593 |
| Tech & Transport Dummy | −0.026 | [−0.212, 0.159] | 0.781 |
| Trade Dummy | −0.063 | [−0.213, 0.086] | 0.407 |
| Year | −1.093, | [−3.799, 5.986] | 0.661 |

Columns 1-3 list the RDD estimate, confidence intervals and p-values of the pre-treatment covariate listed on the left at the cutoff of 2000 employees. All estimates are calculated with MSE-optimal bandwidths. Standard errors for the confidence intervals and p-values are robust to the bandwidth selection.

Analysis - Regression Discontinuity

To choose a bandwidth in which the assignment of the treatment is plausibly random, I rely on the data-based bandwidth selection method proposed by Cattaneo, Calonico and Titiunik (2015). To obtain the optimal bandwidth, I use a subsample of all firm-year observations with more than 1500 and less than 2500 employees. The result is an optimal bandwidth of about 170 employees on each side of the threshold, which includes 103 firms and 242 firm-year observations. [19] However, since the optimal bandwidth calculations are not without criticism, I conduct sensitivity checks by varying the chosen bandwidth.

Figure 3.4 plots the cash holdings of firms with between 1830 and 2170 employees. My argument would expect a discontinuity in savings around the 2000 employee threshold (indicated by dashed vertical line). In line with this expectation, firms in which workers have a larger say in the supervisory board indeed seem to hoard less cash and liquid financial assets. This finding holds independent of whether I employ linear (a) or quadratic fitting (b) around the threshold.

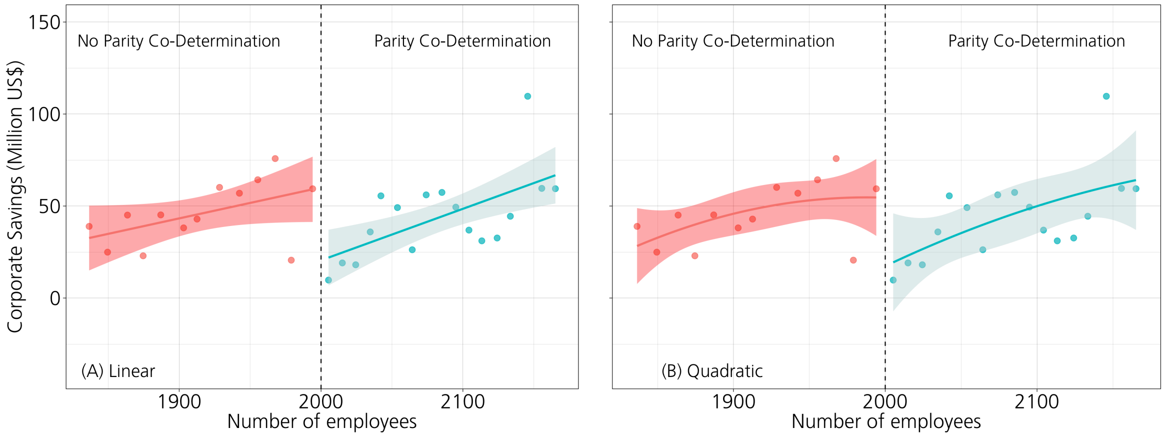



FIGURE 3.4: Regression Discontinuity Plots (90% Confidence Intervals) - Establishment of parity co-determination has a negative effect on corporate savings at the firm level

Table 3 displays the results of the main regression discontinuity analysis. Following Cattaneo, Calonico and Titiunik (2015), I report the local average treatment effect of LPC on corporate savings in its conventional form as well as bias-corrected and robust estimators. Model 1 reports the baseline estimates. For mid-sized firms close to the 2000 employee threshold, those that are legally mandated to occupy half of their supervisory boards with worker representatives display significantly lower levels of corporate savings. The effect is statistically significant and substantially large. On average, firms with LPC hold more than $US 40 Million less in cash and short-term investments than similar firms without labor representation. Model 2 adds industry and year fixed effects and since variation is likely to

[19] I choose the subsample of firms with between 1500 and 2500 firms, rather than the full sample (ranging from companies with 10 to 60 000 workers) because the above-mentioned optimal bandwidth algorithms otherwise choose bandwidths that are too large (e.g., 1000 employees) to make credible causal inferences.

vary across different firms, model 3 furthermore clusters standard errors at the individual firm level. This does not change the results substantially.

Table 3.3: The effect of labour parity co-determination on firm-level cash-holdings

| | RD Effect of Parity-Codeterminaiton on Corproate Savnigs | | | | |
|---|---|---|---|---|---|
| | Outcome: Corporate Savings | | | | |
| | Estimate | 95% CI | p-value | controls | clustered SE |
| Parity Co-determination | −45.699 | [−88.327, −3.071] | 0.036 | No | No |
| Parity Co-determination | −47.174 | [−89.485, −4.864] | 0.029 | Yes | No |
| Parity Co-determination | −46.5163 | [−91.430, −1.602] | 0.042 | Yes | Yes |

The dependent variable of all models are firm-year observations of corporate savings, measured as the sum of cash holdings and short-term investments (in millions). Estimate is the average treatment effect at the cutoff of 2000 estimated with local linear regression with triangular kernel and a common MSE-optimal bandwidth of 164 employees at each side of the cutoff. Controls include fixed effects for years and sectors (manufacturing, service, trade and IT) and different measures of ownership concentration. Clustered standard errors cluster at the individual firm level.

### Robustness Checks

I conduct a range of robustness checks. As the law on co-determination only applies to domestic employees, I reduce the sample to firms which have no foreign affiliations to make sure that the number of total employees listed in Compustat does not include workers outside of Germany. As shown in Table B.1 (p.10) in the supplementary materials, this increases the magnitude of the effect while not affecting its statistical significance. As cash holdings are not normally distributed across firms, I rerun the RDD with logged savings as the dependent variable and also calculate the effect of parity co-determination on savings as a share of total assets. This does not change the results substantially and on average firms at the cut-off hold about 4.3 percentage points less in savings if they have to implement LPC (see Table B.2 (p.10) in supplementary materials). To further corroborate this finding, I conduct placebo tests with arbitrarily chosen alternative cut-offs. If corporate savings are actually decreased by the implementation of LPC, negative effects should *only* occur at the mandatory threshold of 2000 employees. As Figure 3.5 displays, I find no indication that the level of corporate savings changes at randomly chosen alternative thresholds. To further rule out that the negative effect of crossing the threshold stems from something else than increased labor power, I rerun the RDD in countries, which do not have similar changes of regulation at this cut-off. As Figure 3.B.5 in the supplementary materials (p.11) shows, negative effects occur only in Germany. Furthermore, Figure 3.B.6 in the appendix shows the that my findings are not sensitive to the size of the bandwidth chosen.

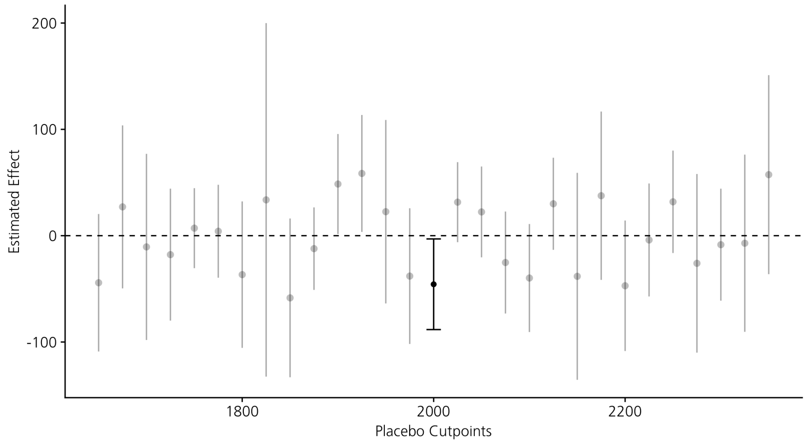



FIGURE 3.5: Placebo Tests with 95% Confidence Intervals - The negative treatment effect occurs only at the 2000 employee threshold.

As a final robustness check, I also change the identification strategy. Exploiting the panel structure of my data, I use a difference-in-difference design to compare the average change in savings in firms that cross the 2000 employee threshold to those that remain beneath it. Even in this very different set-up I find that adopting co-determination has a negative effect on savings, which turns significant two years after the establishment of LPC and which seems to become stronger (though also more imprecisely measured) over time. Details of the estimation and the full results can be found in the appendix (p.12).

Mechanisms

Finally, I also look into the mechanisms that my argument suggests. In theory, firms could decrease savings either by paying higher dividends to shareholders, by increasing remuneration for employees or by investing more. I argue that larger labor power leads to lower savings, as it enables employees to pressure firms into using revenues in ways that benefit their interests - above all for labor expenses and productive investment. Compustat data on firm expenses is more limited than for savings. Nonetheless, Table 4 shows evidence in line with these arguments. While the establishment of parity-co-determination actually significantly lowers payouts to shareholders, it has positive but non-significant effect on expenses for wages and salaries.[20] However, other labor related expenses - which include employee benefit plans and other social expenditures as well as pension and retirement expenses - significantly increase at the threshold. Similarly, increased labor power also seems to have the expected positive effect on firm-level investment, measured as the annual change in total capital growth. The fact that data on these items is more patchy than for savings warrants caution. Nonetheless, these findings buttress the argument that higher labor power makes it more likely that surplus revenues are used in ways that benefit employees instead if being stashed in liquid assets.

Table 3.4: Mechanisms: Effect on firms' spending behaviour

| | RD Effect of Parity-Codeterminaiton on Spending Behaviour | | | | | |
|---|---|---|---|---|---|---|
| | Dividends, Staff Expenses & Investment | | | | | |
| | Estimate | 95% CI | p-value | bandwidth | controls | clustered SE |
| Dividends | -0.02 | [−0.042, −0.003] | 0.033 | 175 | Yes | Yes |
| Staff Expenses (Wages & Salaries) | 0.066 | [−0.055, 0.186] | 0.287 | 106 | Yes | Yes |
| Staff Expenses (Other) | 0.039 | [0.015 , 0.063] | 0.001 | 137 | Yes | Yes |
| Investment | 0.127 | [0.014, 0.240] | 0.027 | 104 | Yes | Yes |

Dividends compromise the total amount of dividends declared on all equity capital of the company. Staff expenses (wages & salaries) include all labor expenses that are linked to the direct remuneration of workers. Staff expenses (other) captures forms of indirect remuneration of labor such as employee benefits plans and other social expenditure, pension and retirement expenses as well as social security contributions. The items are scaled by firm size measured in total assets. Investment is defined as the capital growth rate measured in annual changes of total investment (Peters and Taylor, 2017) divided by lagged total assets. Estimate is the average treatment effect at the cutoff of 2000 estimated with local linear regression with triangular kernel and MSE-optimal bandwidths. Controls include fixed effects for years and sectors (manufacturing, service, trade and IT). Standard errors are clustered at the firm level.

Overall, these tests support my theory. Since the strategy of hoarding cash and liquid assets on financial markets is at odds with the direct interests of workers, firms that are legally required to establish parity representation in their supervisory boards have significantly lower levels of savings. These findings make it plausible that the broader erosion of profit-sharing capacities have contributed to the global rise of corporate savings.

### 3.5 Conclusion

The rise of corporate savings constitutes a silent but fundamental transformation in the functioning of some advanced economies. Firms in many developed countries seem increasingly reluctant to use their profits as means to expand their business, to increase payouts to shareholders or to raise wages. Instead they retain large shares of their revenues, accumulate

[20] Besides a lack of statistical power, one reason for why we do not see a larger effect here could be that this item of course also includes expenses for executive salaries and bonuses. If parity co-determination not only increases wages for workers but also limits executive pay, the two effects could cancel each other out.

big portfolios on financial markets and have turned into a net lender to other sectors. This development is not only economically puzzling. It also contributes to a long list of political and economic problems, ranging from rising inequality to heated financial fragilities and an actuation of global imbalances.

Much of the existing research ascribes the surging of corporate savings to macroeconomic and structural factors. This paper has argued that political factors play an important role in mitigating the trend. It suggests that stashing surplus profits on financial markets is at odds with the material interests of workers and employees. The erosion of political institutions and environments that strengthen the profit-sharing capacities of labor, therefore, has substantially contributed to the emergence the corporate savings glut.

I test this claim using panel data from 25 OECD countries as well as by exploiting a natural experiment provided by the German law on co-determination. At the cross-national level, I find a robust association between the decline of trade-union power and the rise of corporate savings. In addition, the firm level provides causal evidence that increasing the profit-sharing capacities of workers, indeed, leads to reduced savings and an increase labor related expenses and investments.

For theory, these findings contribute to a burgeoning literature on the domestic sources on global imbalances and financial fragilities (e.g. Ahlquist, 2010; Baccaro and Pontusson, 2016) as well as to research on the political and economic consequences of declining labor power in advanced economies (e.g. Becher, Stegmueller and Käppner, 2018). Especially, the paper shows that declining labor power not only affects the division of the economic pie between capital and labor (Kristal, 2013). It also influences whether profits end up being banked up on financial markets or are spent in ways that stipulate growth and employment. For policy, the finding that strengthening employee's voice in corporate decision making has important implications for firms' saving and spending behavior can help to inform ongoing debates about possible policy strategies to strengthen the link between capital profits and general welfare.[21]

However, three caveats should be addressed in future work. First, skeptics of my approach might point out that the forms of profit-sharing capacities I investigate at the cross-country and the firm level are quite different. While I would argue, that trade unionism and parity

[21] For a recent example, see debates about Sen. Warren's Accountable Corporatism Act in the US (Klein, 2018).

co-determination are both factors that strengthen workers ability to champion their interests, future research could take a more systematic look into how specific profit-sharing capacities mitigate corporate savings. Second, while most savings are still held in cash and short-term investments, not all forms of retained profits necessarily fall into this category. It is thus going to be important to find ways to include long-term financial assets into the measurement of savings. Finally, this paper has focused on the distributional conflict between workers and management. However, for an encompassing picture of the rise of corporate savings, future research should further unpack the capital side of the story. Especially in listed firms, it remains striking why stock owners do not insist on higher payouts. Future research should thus investigate the political context conditions that change owners preferences or enable management to pursue saving strategies against the interests of owners.

# Supplementary Materials

## 3.A Supplementary Material Cross-National Study

### 3.A.1 Construction Corporate Net-Saving Data at the Country Level

I obtain data on corporate savings at the county level from Chen, Karabarbounis and Neiman (2017), who base their calculations on information from national accounts provided by the United Nations and the OECD. These accounts divide the economy into the corporate sector, the household sector and the government sector. For all the countries considered in this study, national accounts allow to further disaggregate the corporate sector into a financial and a non-financial sector.

Corporate net saving positions can be calculated based on a couple of accounting identities that serve as the backbone of these national accounts. First, in these accounts the value of the final production in a country is called the gross-value added (GVA), which equals the national GDP less net taxed on products. GVA is detailed in the generation of income account and equals the sum of income paid to capital, labor, and taxes:

$$GVA = Gross\ Operating\ Surplus\ (GOS) + Compensation\ to\ Labor + Net\ Taxes\ Production \tag{3.A.1}$$

In this equation, GOS captures the income available to corporations after paying for labor and subtracting taxes and adding subsidies associated with production. The GOS the can be further disaggregated into gross saving, dividends, and other payments to capital such as taxes on profits, interest payments, reinvested foreign earnings, and other transfers:

$$\begin{aligned} GOS = {} & Gross\ Saving\ (GS) + Net\ Dividends + Taxes\ on\ Profits \\ & + Interests\ - Reinvested\ Earnings\ on\ FDI. \end{aligned} \tag{3.A.2}$$

Finally, the gross saving of the corproate sector at the national level can be further decomposed through the capital account identity:

(3.A.3)

$$GS = Net\ Lending\ (NL) + Gross\ Fixed\ Capital\ Formation + Changes\ in\ Inventories$$
$$+ Changes\ in\ Other\ Non\ Financial\ Produced\ Assets + Net\ Capital\ Transfer.$$

In the paper, I follow Chen, Karabarbounis and Neiman (2017) in defining my final measure of corporate savings as Gross Savings subtracted by Gross Fixed Capital Formation, i.e. as the excess of gross savings over investment spending. As evident from the identity above, this definition slightly differs from the identities in the national accounts. However, since the remaining items are small and stable over time, this measure of corporate savings comes very close to the that in the national accounts (Chen, Karabarbounis and Neiman, 2017).

### 3.A.2 Multiple Imputation for TSCS Analysis

To avoid any biases that might result from missing values in my time-series cross-country analysis, I use multiple imputation. The core idea of multiple imputation models is that any case in a sample can be replaced by a new randomly chosen case from the same source population (Donders et al. 2006). Thus, in the case of a missing value in a variable this missing is replaced by a value drawn from an estimate of the distribution of this variable. This process is then called imputation. In the case of multiple imputation, not only a single estimate is used to replace the missing, but various estimates are used. This method is superior to more ad-hoc measures of dealing with missings such as pairwise deletion, if missings are not completely at random, i.e. if probability that a given value is missing does (at least partially) depend on information in the dataset (Honaker and King, 2010). As multiple studies have shown, this is the case for many political science datasets and especially for the macroeconomic and macro-political variables I use in my analysis (Cranmer and Gill, 2013; Lall, 2016).[22]

To impute the data, I follow the procedure described in Honaker, King and Blackwell (2011). For choosing the number of imputations, I use the average missing-data rate of the

[22]To improve the numerical stability of the algorithm, I shrink the covariance of the variables in the model by including a positive rigid prior I also include a positive rigid prior as described in Honaker, King and Blackwell (2011).

Table 3.A.1: Chain length of imputations

| | |
|---|---|
| Imputation 1 | 31 |
| Imputation 2 | 38 |
| Imputation 3 | 30 |
| Imputation 4 | 22 |
| Imputation 5 | 26 |

variables in the model (Lall, 2016) which in my data set is five. In the imputation model, I include all variables in the subsequent analysis and add a number of variables that have few missing values and that are likely to be correlated with the covariates such as in ation, unemployment, capital and trade openness, fiscal deficits and the share of high-tech exports. Given the tscs structure of my data, my imputation model also makes use of lags and leads of the key variables (Honaker and King, 2010).

To give a better idea of the fit of the imputation model, Figure 3.B.4 shows overimputed values of trade union densitsy. Overmputing treates observed values of a variable as if they had been missing. For each observed value, several hundred imputed values of that observed value are generated using the imputation algorithm. Figure 3.B.4 plots the estimation of each observation against its true value as well as 90 % confidence intervals. For a good fit, around ninety percent of these confidence intervals should contain the y = x line. The color of the lines represents the fraction of missing observations in the pattern of missingness for that observation (e.g. blue=0-2 missing entries).

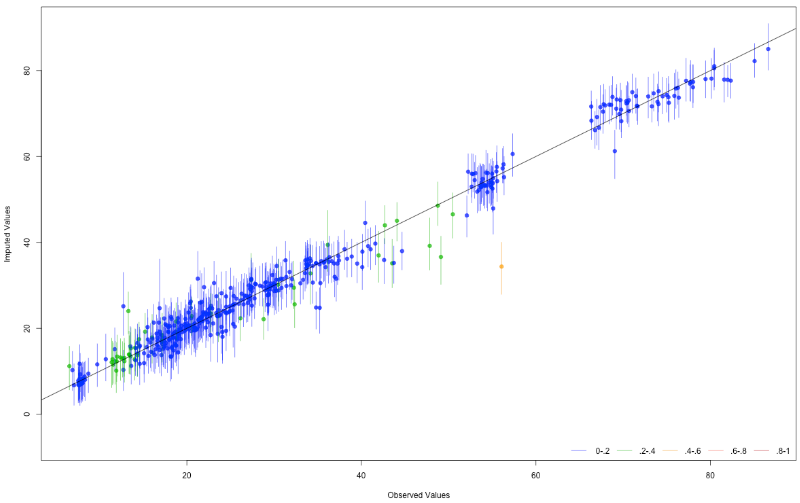



Figure 3.A.1: Overimputed values of trade union density.

### 3.A.3 Descriptives & Summary Statistics

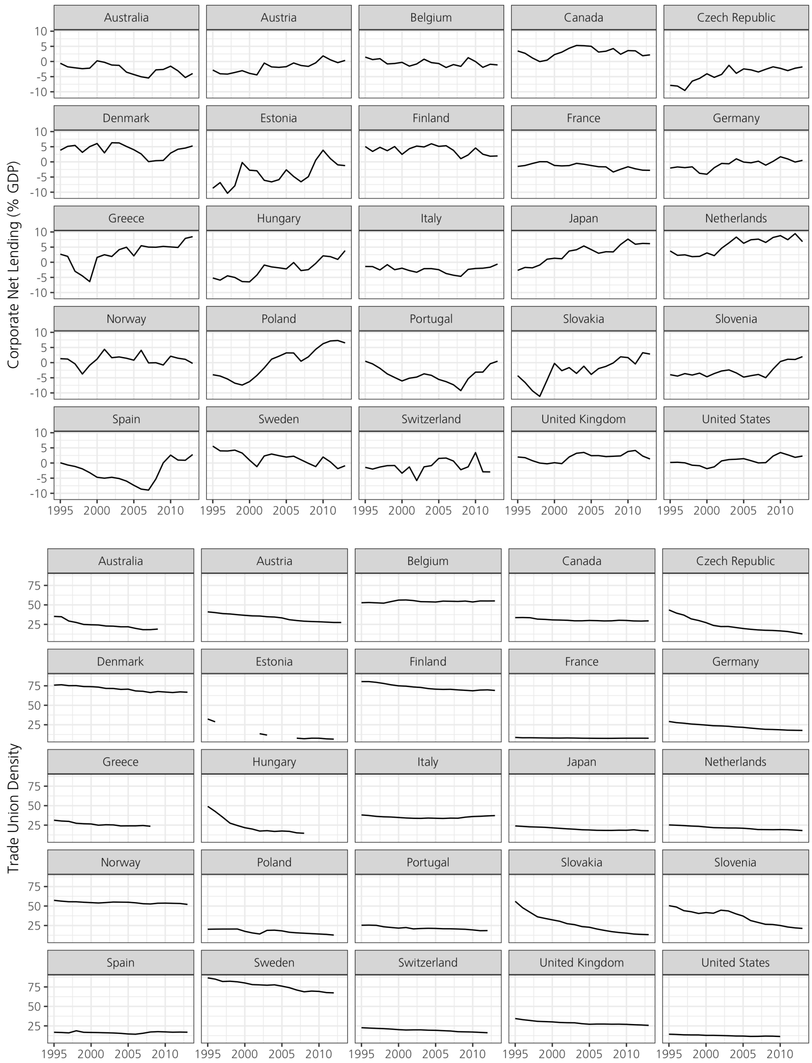



FIGURE 3.A.2: Development of Corporate Savings and Trade Union Density across countries and time

### 3.A.4 TCSC Analysis: Bargaining Coverage as an Alternative Measure of Labor Power

Table 3.A.2: Higher Trade Union Density is associated with lower Corporate Savings

| | *Dependent variable:* | | | |
|---|---|---|---|---|
| | Corporate Savings (% GDP) | | | |
| | (1) | (2) | (3) | (4) |
| Bargaining Coverage | −0.098*** | −0.110*** | −0.067*** | −0.065*** |
| | (0.017) | (0.018) | (0.019) | (0.020) |
| RTI Score | | −0.433** | −0.135 | −0.189 |
| | | (0.199) | (0.136) | (0.141) |
| FDI out (% GDP) | | −0.002 | 0.007 | 0.014 |
| | | (0.016) | (0.015) | (0.013) |
| Real GDP Growth | | −0.007 | 0.035 | 0.039 |
| | | (0.042) | (0.032) | (0.067) |
| Crisis Dummy | | −0.890** | −1.126*** | |
| | | (0.417) | (0.323) | |
| Stock Capital. | | | −0.009** | −0.010* |
| | | | (0.005) | (0.005) |
| Old Age Dep. | | | 0.318*** | 0.314*** |
| | | | (0.063) | (0.074) |
| Corp. Income Tax | | | −0.011 | 0.005 |
| | | | (0.026) | (0.027) |
| Country Fixed Effects | ✓ | ✓ | ✓ | ✓ |
| Year Fixe Effects | × | × | × | ✓ |
| Observations | 295 | 295 | 295 | 295 |
| $R^2$ | 0.708 | 0.729 | 0.749 | 0.775 |
| Adjusted $R^2$ | 0.681 | 0.699 | 0.718 | 0.729 |
| Residual Std. Error | 2.176 (df = 269) | 2.112 (df = 265) | 2.044 (df = 262) | 2.002 (df = 245) |
| F Statistic | 26.054*** (df = 25; 269) | 24.556*** (df = 29; 265) | 24.405*** (df = 32; 262) | 17.176*** (df = 49; 245) |

*Note:* *p<0.1; **p<0.05; ***p<0.01

Bargaining coverage measures the share of employees covered by collective (wage) bargaining agreements as a proportion of all wage and salary earners in employment, adjusted for the possibility that some sectors are excluded from the right to bargain (Visser, 2015). Higher values of bargaining coverge, thus, indicate higher levels of labor power. Models are based on a Prais-Winsten transformation and show panel corrected standard errors.

## 3.B Supplementary Material RDD Germany

### 3.B.1 Calculating Firm-Level Corporate Savings

To calculate corporate savings based on information on Compustat, I proceed in three steps. First, a firm's gross operating surplus (GOS) equals total sales less operating expenses plus depreciation and expenses for research and development (R&D):

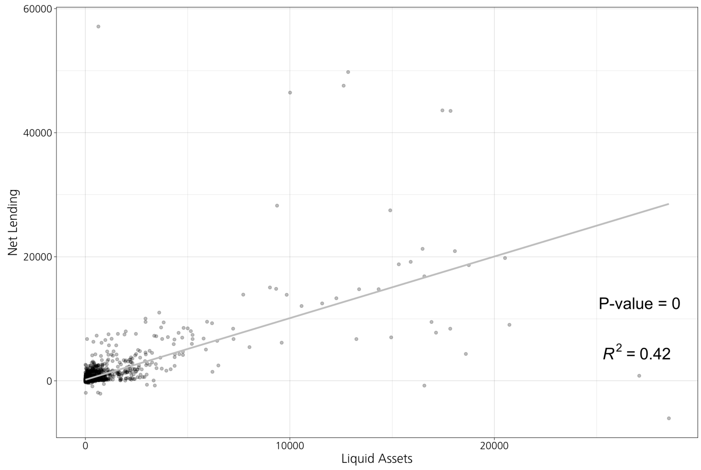
$$GOS_{f,t} = Sales_{f,t} - Operating\ Expenses_{f,t} + Depreciation_{f,t} + R\&D_{f,t} \tag{3.B.1}$$

Gross savings (GS) at the firm level can then be calculated by removing expenses for interests, corporate taxes and dividends from my measure of GOS.

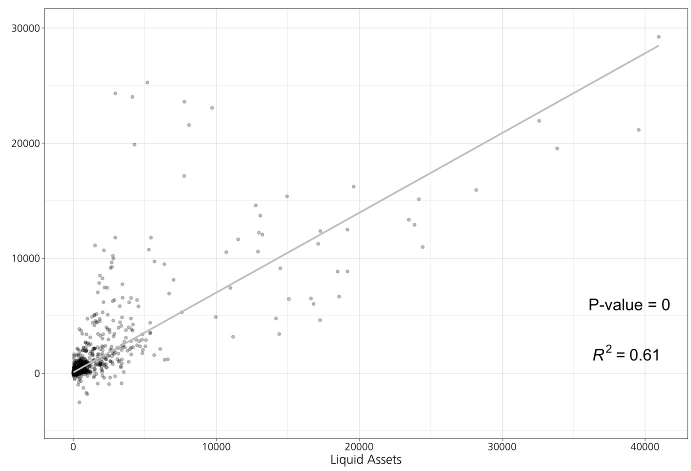
$$GS_{f,t} = GOS_{f,t} - Corporate\ Taxes_{f,t} - Interests_{f,t} - Dividends_{f,t} \tag{3.B.2}$$

Finally, net saving is defined as the excess of gross savings over investment. Investment equals fixed capital formation (FCF) at the firm level and can be obtained by calculating expenses for acquisitions less income from sale and disposals of property, plant, and equipment, plus R&D expenditure. I thus am able to construct a firm's net lending (NL), i.e. its net savings by calculating:

$$NL_{f,t} = GS_{f,t} - Acquisitions_{f,t} - R\&D_{f,t} + Sale\ of\ PPE\ Gains_{f,t} \tag{3.B.3}$$




(A) 1990 - 2000: Cash holding and Net Savings




(B) 2008 - 2015: Cash holding and Net Savings

Figure 3.B.3: Cash holding and Net Savings

### 3.B.2 RDD Robustness Checks

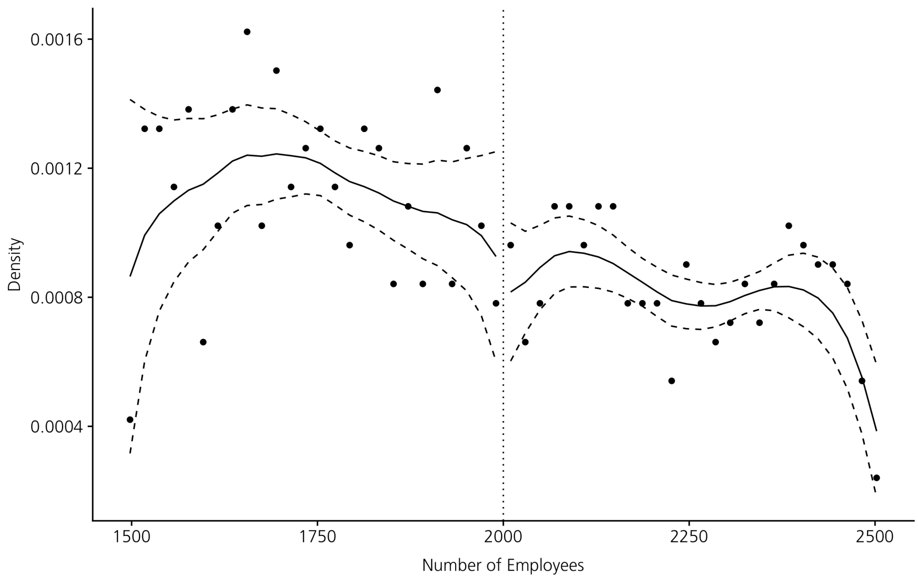



FIGURE 3.B.4: McCrary Density Test Plot

Table 3.B.1: The effect of labour parity co-determination on firm-level cash-holdings

| | RD Effect of Parity-Codeterminaiton on Corproate Savnigs<br>Robustness Excluding Firms with Foreign Subsidiaries | | | | |
|---|---|---|---|---|---|
| | Outcome: Corporate Savings | | | | |
| | Estimate | 95% CI | p-value | controls | clustered SE |
| Parity Co-determination | −58.65 | [−110.151 , −7.148] | 0.026 | No | No |
| Parity Co-determination | −58.074 | [−109.425, −6.723] | 0.027 | Yes | No |
| Parity Co-determination | −58.893 | [−111.374, −6.413] | 0.028 | Yes | Yes |

The dependent variable of all models are firm-year observations of corporate savings, measured as the sum of cash holdings and short-term investments (in millions). Estimate is the average treatment effect at the cutoff of 2000 estimated with local linear regression with triangular kernel and a common MSE-optimal bandwidth of 176 employees at each side of the cutoff. Controls include fixed effects for years and sectors (manufacturing, service, trade and IT) and different measures of ownership concentration. Clustered standard errors cluster at the individual firm level.

Table 3.B.2: The effect of labour parity co-determination on firm-level cash-holdings

| | RD Effect of Parity-Codeterminaiton on Corproate Savnigs<br>Robustness for different Measures of Corporate Savings | | | | | |
|---|---|---|---|---|---|---|
| | Outcome: Corporate Savings | | | | | |
| | Estimate | 95% CI | p-value | bandwidth | controls | clustered SE |
| Logged cash | −1.088 | [−2.043 , −0.134] | 0.025 | 133 | Yes | No |
| Logged cash | −1.068 | [−2.143 , 0.006] | 0.055 | 138 | Yes | Yes |
| Savings (share total assets) | −0.043 | [−0.084, −0.002] | 0.040 | 158 | Yes | No |
| Savings (share total assets) | −0.043 | [−0.085, 0.000] | 0.050 | 152 | Yes | Yes |

The dependent variable of all models are firm-year observations of corporate savings, measured as the sum of cash holdings and short-term investments (in millions). Estimate is the average treatment effect at the cutoff of 2000 estimated with local linear regression with triangular kernel and a common MSE-optimal bandwidth. Controls include fixed effects for years and sectors (manufacturing, service, trade and IT). Clustered standard errors cluster at the firm level.

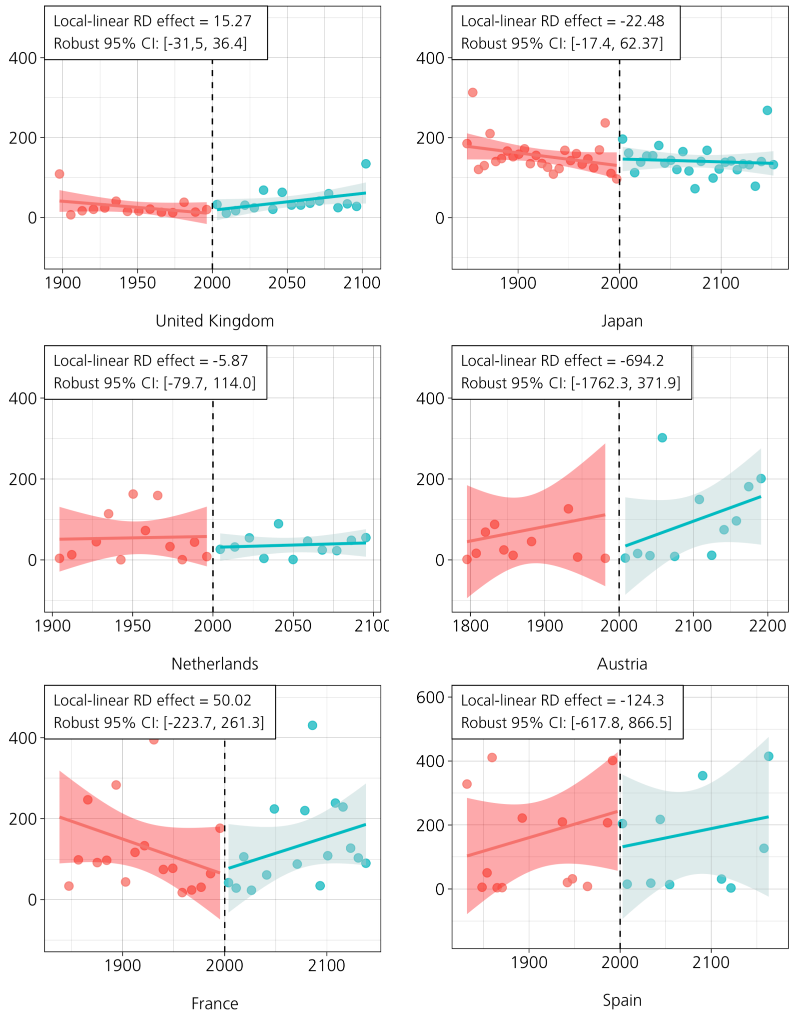



FIGURE 3.B.5: Alternative Placebo Test. There is no jump in corporate savings at the 2000 employee threshold in countries without the establishment of parity-co determination. All models include robust bias-corrected standard errors and a MSE-optimal bandwidth selector.

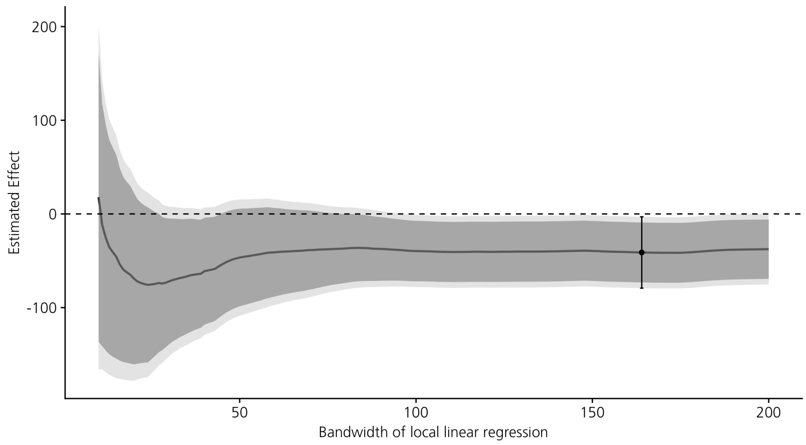



FIGURE 3.B.6: Alternative RDD specifications with changing windows of domestic employees around the threshold of 2,000. All models include robust bias-corrected standard errors.

### 3.B.3 Firm-Level Difference-in-Difference Tests

As an alternative strategy to estimate the effect of parity co-determination on savings at the firm level, I exploit the panel structure of the firm-level data and use a difference-in-difference strategy to compare the average change in savings in firms that cross the 2000 employee threshold and have to establish co-determination (treatment group) to those that remain beneath it and thus do not have change the composition of their supervisory boards (control group). The difference between these two changes identifies the average treatment effect on the treated. The identifying assumption of this design is that the savings in firms in the treatment group (those that cross the 2000 employee), on average, followed the same trend as firms in the control group (firms that also grow but stay below the threshold). I implement the difference-in-difference strategy using a two-way fixed effect estimator controlling for firm and year fixed effects. I substantiate the identifying assumption by constructing a specification that estimates not only the treatment effect but also allows me to assess to what extent companies in treatment and control followed parallel trends in previous years. The specification looks as follows

$$Y_{i,t} = \gamma_i + \lambda_t + \sum_{\tau=0}^{m} \delta_{-\tau} \cdot D_{i,t-\tau} + \sum_{\tau=1}^{q} \delta_{+\tau} \cdot D_{i,t+\tau} + \beta X_{i,t} + \epsilon_{i,t}, \tag{3.B.4}$$

where $Y_{i,t}$ represents savings in firm $i$ at time $t$ an $D_{i,t}$ is an indicator equaling one if a firm $i$ has crossed the 2000 employee threshold at time $t$ and zero otherwise. In addition, the specification includes $m$ lags $(\delta_{-1}, \delta_{-2}, ..., \delta_{-m})$ or post-treatment effects and q leads $(\delta_{+1}, \delta_{+2}, ..., \delta_{q})$ or anticipatory effects. If the identifying assumption is valid, I would expect that there is no statistically significant differences between firms in treatment and control in the years preceding the establishment of parity co-determination. In addition, the inclusion of several lagged periods allows me to study how the effect of increased labor power develops over time. Finally, $X_{i,t}$ is a vector of control variables. To develop credible counterfactuals, it is above all important to control for the different growth rates of firms that grow over the threshold and companies that stay below it. If firms that grow over the threshold, for example, are generally more dynamic than those that stay below it, this could influence savings independent of the establishment of parity co-determination. I thus control for firm growth as the change of numbers of employees in the entire time period under consideration.

In addition, I also control for the total number of employees as well as sector fixed effects. I use cluster-robust standard errors on the firm level, the level of the treatment variation.

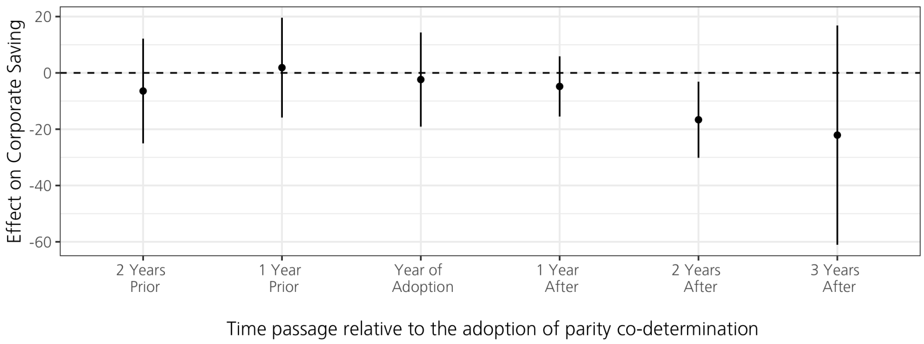



FIGURE 3.B.7: Estimated impact of parity co-determination on corporate savings (in million \$US) for years before, during, and after adoption: Difference-in-difference estimates with 95% confidence intervals cluster-robust standard errors at the firm level.

Figure 3.B.7 plots point estimates and 95% confidence intervals of the effect of parity co-determination on corporate savings for the two years before and three years after the crossing of the 2000 employee threshold. In line with the identifying assumption it shows that the placebo estimates for the two years preceding the adoption of co-parity determination remain indistinguishable from zero. With the implementation of co-determination, however, the estimated effect turns negative and two years after the adoption the effect reaches statistical significance ($\delta$=-.16.6, p=0.016). In the following year, savings of firms with and without parity co-determination grow further apart. However, the effect also becomes more imprecisely measured. Overall, the difference-in-difference estimation points into a similar direction as the RDD. Increasing labor power has a negative and lasting effect on corporate savings.

# Chapter 4

# Distributive Conflicts and Interest Group Conflicts in Surplus Countries

## with Stefanie Walter and Ari Ray

**Abstract**

A key characteristic of the Eurozone crisis is that the burden of adjustment was carried almost exclusively by crisis countries. Surplus countries did not contribute to the necessary rebalancing, even though internal adjustment likely would have reduced some of the pressure on deficit states. We argue that surplus countries' resistance to internal adjustment is rooted in domestic distributive struggles about the design of possible adjustment policies. To explore this argument, we leverage original survey data from 357 economic interest groups from Germany, Austria and the Netherlands and qualitative interviews with interest group representatives. We show that although there is general support for internal adjustment among economic interest groups, they disagree heavily about how exactly to achieve this goal. Together with a broad consensus to avoid a break-up of the Eurozone, the resulting deadlock turned interstate financing – such bailouts to crisis countries – into a politically attractive strategy. Rather than being rooted only in ordoliberal ideology or export orientation, distributive conflicts, thus, contributed significantly to surplus countries' resistance to adjust.

**Acknowledgments**

We are grateful to Alex Roth for his outstanding research assistance. We would also like to thank seminar and conference participants at DVPW 2017, CES 2017, 2018, MPSA 2018, the IR workshop at Harvard in spring 2017 and the One Crisis, Many Perspectives workshop at UZH in 2018. In particular, we would like to thank Jeffry Frieden, Silja Häusermann, Martin Höpner, Kathleen Thelen, Thomas Sattler, John Freeman, Waltraud Schelkle and two anonymous reviewers for their very helpful input and comments.

## 4.1 Introduction

One of the most puzzling aspects of the Eurozone crisis has been the limited amount of burden sharing amongst the members of the monetary union (Blanchard, Erceg and Lindé, 2017; Frieden and Walter, 2017). Rather than write-off substantial parts of the accumulated debt, boost domestic demand to revive economic growth in the Eurozone, and rebalance their export overhangs, surplus countries were content to see the crisis-ridden deficit countries shoulder the brunt of the pain of crisis resolution. Most strikingly, surplus countries have been reluctant to rebalance their current account. In theory, such rebalancing could be achieved in two ways. In practice, surplus countries never seriously entertained the first option, external adjustment, which would have involved a breakup of the Eurozone and, subsequently, an appreciation of their nominal exchange rates. However, surplus countries were also reluctant to engage in internal adjustment as a second option—that is a boost in domestic demand, for example through more public investment or wage increases—which leads to more domestic consumption, more imports, and, as a result, a reduction of the export overhang. Instead they opted for very restrictive type of financing: they provided deficit countries with bailouts.[1] What explains this resistance to rebalancing in surplus states?

Research on the sources of this reluctance has only recently begun to emerge. Some authors have argued that surplus countries have been led by ordoliberal ideas: The belief that the Eurozone's problems could be resolved if deficit states reformed their economies to regain competitiveness, whereas a stimulation of growth and inflation in surplus countries would only risk surplus countries' hard-earned standing in international markets and endanger price stability (Brunnermeier, James and Landau, 2016; Dullien and Guérot, 2012; Matthijs and Blyth, 2015; Schäfer, 2016; Young, 2014). Some even argue that these ideas were so strong that they trumped surplus states' material interests in a more cooperative approach to Eurocrisis management (Matthijs, 2016). A second strand of research strongly contests this notion and argues that surplus countries refused to share the adjustment burden precisely

[1] These bailouts mostly took the form of loans, which have to be repaid fully to the creditor countries. However, there are some debates as to whether the favorable conditions on these loans, including long maturities and low interest rates, amount to indirect transfers to deficit countries (Gourchinas, Martin and Messer, 2018), but in any case, these potential transfers remained rather limited.

This chapter is also published as Chapter 6 in a joint book manuscript with Stefanie Walter, Ari Ray and Raphael Reinke, which is forthcoming at Oxford University Press (Walter et al., 2019) because it benefitted the economic interests of core economic sectors in these countries, such as the financial and the export industries (Hall, 2012; Leupold, 2015; Steinberg and Vermeiren, 2015). This structural perspective is rooted in the literature on the varieties of capitalism, especially research on different growth models (Baccaro and Pontusson, 2016; Hall and Soskice, 2001). It argues that the need to preserve export competitiveness in surplus countries creates a large coalition of policymakers, employers, and workers, all of whom are opposed to measures that would lead to internal adjustment, expanded domestic demand, higher inflation, and increased domestic wages (Hall, 2012, 2015; Höpner and Lutter, 2018; Mahnkopf, 2012; Thompson, 2015). This research suggests that in the international negotiations about the terms of the bailouts, adjustment programs, and economic policy reforms, surplus country governments acted in line with the dominant concerns of their domestic economies (Schimmelfennig, 2015; Streeck and Elsässer, 2015; Thompson, 2015).

Both approaches have greatly advanced our understanding of the politics of the Eurozone crisis. Yet they also have some blind spots. For one, existing explanations suggest that domestic actors in surplus countries tend to be rather homogenous in their pursuit of certain crisis policies, either because of the dominance of economic ideas or because safeguarding the export-led growth model constitutes the national interest. Yet, analogous to the distributive struggles in deficit countries (Eichengreen, 1992; Simmons, 1997; Walter, 2013), adjustment politics in surplus countries generate diverging interests. By focusing on a homogenous national interest or economic ideology, existing approaches cannot account for divergent societal preferences and their influence on policymaking. Second, both structural and ideational approaches have not investigated the empirical framework conditions of their theory. While scholars stressing the role of ordoliberal ideas have provided compelling arguments for the relevance of economic orthodoxy for surplus-country policymaking, there is little work on the questions under what circumstances these ideas were particularly influential. Similarly, structural approaches rest on a number of microlevel assumptions about interest group preferences, which authors in this research tradition have themselves identified as being treated as a "black box" (Baccaro and Pontusson, 2016, p.200-201). The following two chapters, thus, complement existing approaches with a systematic empirical analysis of the preferences of interest groups and voters and the way they interacted with the ideas of policymakers in shaping crisis outcomes. Third, existing approaches concentrate on singular aspects of crisis management such as bailout conditions or wage-setting issues. Macroeconomic adjustment decisions are, however, multidimensional. Resistance to internal adjustment, for example, has significant consequences abroad. It risks global and regional financial stability and increases the financing needs of deficits states, especially when private capital inflows into these countries dry up. Understanding why surplus countries opt against adjusting internally, thus also requires understanding how surplus country decision-makers evaluate these alternatives relative to the option of adjusting domestic policies in a way that reduces the current account surplus. Finally, and perhaps most importantly, we still know relatively little how ideational and structural forces interact in shaping crisis politics and policies.

Our analysis in the following two chapters seeks to address these issues by conducting a systematic empirical analysis of the preferences of interest groups and voters and the way in which they interacted with the ideas of policymakers in shaping crisis outcomes. It thus complements existing approaches and sheds more light on the mechanisms and interactions between the different actors who shaped policymaking in surplus countries during the Eurozone crisis.

We start our investigation of domestic crisis politics in surplus countries by studying the preferences of important economic interest groups in this chapter. The structural approach strongly suggests that economic interest groups played a key role in the domestic politics of the Eurozone crisis. In most surplus countries in the Eurozone, economic interest groups are traditionally deeply involved in economic policymaking. Countries such as Germany, Austria, Finland, and the Netherlands are often characterized as neo-corporatist or coordinated market economies (Hall and Soskice, 2001; Nölke, 2015; Schmitter and Streeck, 1991; Streeck and Thelen, 2005). In these countries, close and often institutionalized networks exist between state actors, unions, and business groups. To overcome collective-action problems, these networks provide market actors with privileged access to policymakers. Organized interest groups are actively integrated into national policy-making processes and, in turn, help with the implementation of reforms and other economic policy outcomes (Martin and Thelen, 2007). Many of the economic questions underlying the management of the Eurocrisis in surplus countries directly affected the core interests of trade unions, employer associations, or industry groups, and they often had an important voice in important economic political decisions in the crisis years. When discussing whether to expand domestic public investment, the German government in 2014, for example, established a commission that included major trade unions, industry groups, and insurance associations to discuss existing needs and priorities.[2] Given the institutional context in coordinated market economies, economic interest groups were, thus, in prime positions to have an active say in how their governments approached key policy questions of the crisis.

Interest groups also matter in the context of ideas-based approaches because voters often use heuristics, such as cues by economic interest groups, to form opinions on complex matters, such as financial crises (Kim and Margalit, 2017; Mcdermott, 2006). Metal industry workers will likely not invest their evenings reading into the macroeconomics of balance-of-payments crises. However, they may consider the position of their trade union when thinking about whether their government should support international bailouts or not. There are numerous examples of such clue rendering in the crisis. During the run-up to the Dutch parliamentary elections of 2012, for example, a large coalition of Dutch employer associations ran a large public campaign emphasizing the importance of Europe for the Dutch economy and to counter widespread skepticism about the bailouts and integration more generally.[3] Economic interest groups, thus, often provide important information to broader electoral groups; they transport their ideas and interests into the wider electoral politics.

Despite broad agreement that organized interests played an important role in surplus countries' management of the Eurozone crisis, virtually no systematic and comparative empirical research on the specific preferences of these groups exists. A deep understanding of these preferences and the constraints they impose on policymakers is important, however, for a substantive analysis of the role of interest groups in Eurozone politics. This chapter addresses this lacuna. It analyses interest groups' policy preferences on Eurozone policies using unique data we collected with an online survey of more than 350 employer associations, trade unions, and social policy groups in Germany, Austria, and the Netherlands. In addition, it leverages information from more than 30 in-depth interviews with interest group representatives and policymakers in these three countries.

[2] https://www.bmwi.de/Redaktion/DE/Pressemitteilungen/2016/20160914-expertenkommission-zur-steigerung-der-investitionen-in-deutschland-zieht-bilanz.html

[3] https://www.vno-ncw.nl/campagnes/europa

Employing the vulnerability profile framework developed in this book, we show that analyzing the distributional conflicts amongst different societal groups in surplus countries helps to understand some important features of the management of the crisis. We find that a large majority of economic interest groups in all surplus countries opposed a breakup of the Eurozone (i.e., external adjustment) and supported internal adjustment through strengthened domestic demand. However, while interest groups uniformly rejected all of Eurozone breakup scenarios, they disagreed heavily about the policies through which internal adjustment should be achieved. The resistance against macroeconomic adjustment in surplus states was largely rooted in distributive struggles about the design of possible adjustment policies. In contrast to the highly politicized issues of external and internal adjustment, financing was a low-salience issue. The polarized views on the specificities of internal adjustment, the broad consensus to avoid breaking up the Eurozone, and the low-salience quality of financing, thus, turned financing into an attractive strategy for surplus country governments.

## 4.2 Domestic Trade-Offs, Vulnerability Profiles, and Adjustment in Surplus Countries

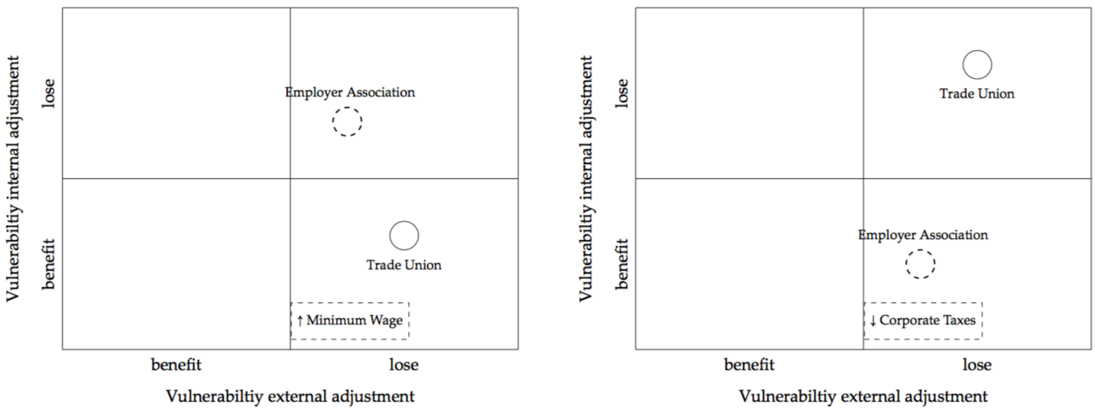
To study the domestic politics of adjustment in surplus countries, we once more use the general vulnerability profile concept developed in this book to analyze the preferences and trade-offs faced by economic interest groups. Mirroring our analyses of deficit country interest group politics discussed in chapter 3, we expect domestic economic interest groups to form their crisis preferences based on the relative costs and benefits they associate with each of the two possible adjustment strategies that surplus countries have in a balance-of-payments crises: internal adjustment and external adjustment—in the case of the Eurozone crisis, a breakup of the monetary union—and the net costs of engaging in financing. Their policy preference will be for the adjustment strategy that benefits them the most or, if all options are costly, the one that costs them the least.[4]

As discussed in the introduction of this disserataion, grouping interest groups by their net vulnerability to the two possible adjustment strategies, we can distinguish between four main ideal types (see Figure 1.5, p. 20). The first type (quadrant I) is vulnerable to internal

[4] We use a stylized example in which governments must choose between the three types of strategies. Of course, combinations of these options are also possible (e.g., some policies increasing domestic demand, some exchange rate appreciation, and some financing). The underlying distributional considerations are likely to be the same in these situations, however.

adjustment but not to external adjustment. As an example, one could think of an interest group representing the poor—a highly inflation-averse group whose purchasing power is enhanced by an appreciated currency. This first type is likely to prefer external adjustment over any other form of crisis management. The second type (quadrant III) would be hurt by a Eurozone breakup but is likely to benefit from a boom in domestic demand. Because internal adjustment creates net benefits for the group but its financing is costly, interest groups of this type will favor internal adjustment over external adjustment or financing. The third type (quadrant II) is vulnerable to both internal and external adjustment. An example for an interest group in this "misery corner" is a group that represents export-oriented firms, who would lose out from both a reorientation towards the non-tradable sector and an appreciated exchange rate. This type of interest group should be the most willing to provide deficit countries with some form of financing rather than supporting macroeconomic adjustment in their own country. Finally, groups that are neither vulnerable to internal nor external adjustment constitute the fourth ideal type (quadrant IV). For these groups, macroeconomic adjustment should be a low-salience issue, and they are likely to prefer adjustment over financing.

These straightforward predictions face one major complication. Each of the three main crisis strategies—internal adjustment, external adjustment, and financing—can be achieved in a variety of ways. Take, for example, internal adjustment, in which the range of possible policies is largest, because it can be achieved in very different ways in surplus countries (Bernanke, 2015; Eichengreen, 1992). For example, policymakers' intent on boosting domestic demand might increase public investment in infrastructure and schools; these policymakers could also reduce corporate taxes or cut red tape for businesses to incentivize private investment. Or they could raise the minimum wage, increase pensions, or expand unemployment benefits. Even though all these measures help to rebalance the economy, their distributional implications differ widely. As a result, interest group vulnerabilities to internal adjustment are likely to be policy-specific (Redeker and Walter, 2018). While one group may benefit from one type of internal adjustment policy, the same group could, at the same time, be hurt by another policy aimed at boosting domestic demand. Depending on the specific policy under consideration, groups will, therefore, end up in different quadrants of our vulnerability profile.




(A) Adjustment through higher minimum wage (B) Adjustment through corporate tax cuts

FIGURE 4.1: Policy-specific vulnerability profiles to internal adjustment: Adjustment through higher minimum wage

Figure 4.1 illustrates this point with a stylized example. It shows the vulnerability profiles of two hypothetical groups—one group representing employers and one group representing low-wage workers, for example a service sector trade union. We assume that both of our fictional groups are vulnerable to the breakup of the monetary union, putting them on the right-hand side of the vulnerability profile. Whether or not they support internal adjustment will then depend on the specific policy under consideration. In Panel A, internal adjustment is achieved through an increase in the minimum wage. Because members of our hypothetical trade union would benefit from higher minimum wages, the group falls in quadrant III and is likely to support internal adjustment. The employer association, on the other hand, is vulnerable to this form of internal adjustment, perhaps because it represents firms that rely on low-paid workers. This puts it in quadrant II. Since it is vulnerable to both a breakup and to the specific form of internal adjustment on the table, we expect it to oppose both external and this type of internal adjustment, and to be more supportive of financing instead. The situation is reversed when the internal adjustment policy under consideration is a reduction in corporate taxes meant to stimulate private investment. Panel B shows that the trade union now finds itself in quadrant II because it is likely to oppose the loss in tax revenue associated with tax cuts for businesses, whereas the employer association is now located in quadrant III and turns into a proponent of internal adjustment.

In the same vein, interest group vulnerabilities towards financing, and to a lesser extent external adjustment, are also policy-specific. The costs that financing puts on different societal groups in surplus countries depend on how exactly funds are provided to deficit states. Bailout packages, for example, are largely borne by the taxpayer, whereas debt relief and haircuts on private surplus country loans to deficit country governments and market actors impose costs on surplus country investors (Copelovitch and Enderlein, 2014; Frieden and Walter, 2017). However, for many forms of financing, it is much more difficult to predict who exactly is going to have to pay the costs of these policies and how high these costs will actually be. The distributive consequences of Eurobonds, the provision of emergency liquidity assistance by the European Central Bank, or its bond buying program for surplus country interest groups are likely to be much more opaque. Even for bailout packages, many question marks remain as to which taxpayers and at what point in time will have to pick up the bill. In sum, none of the financing measures are free, but a majority of them do not produce well-defined groups that will be clearly hurt by these measures. Politically, this means that many of these policies are likely to be less contested than adjustment policies with clearer distributive consequences.

Policy options for external adjustment, in contrast, are much less diverse. Of course, it will make a difference whether a crisis-ridden deficit country, such as Greece, leaves the monetary union, whether the Eurozone as a whole breaks down, or whether a surplus country leaves the club. But despite these different breakup scenarios, any change in the composition of the Eurozone membership would result in some form of market upheaval and an appreciation of surplus countries' exchange rate (Eichengreen, 2010). Few groups are, therefore, going to benefit from one form of external adjustment but hurt by another.

Overall, this discussion suggests that we should expect some variation in how interest groups evaluate different policy options for internal adjustment and financing, and less variation regarding to external adjustment. Especially concerning internal adjustment, policy proposals will garner support from some groups but will also provoke fierce opposition from others based on their policy-specific vulnerability profile. Moreover, we expect the two possible strategies leading to macroeconomic adjustment and rebalancing—internal and external adjustment—to be much more salient for interest groups than financing policies.

The expectation that interest group preferences about surplus country crisis management and especially internal adjustment, are policy-specific and polarized adds some important alternative predictions to the perspectives suggested by the growth model and the ideas-based approaches. Both of these approaches suggest that rebalancing in surplus states is blocked by a broad societal coalition that shares either the common goal of safeguarding the country's export competitiveness (Hall, 2012; Iversen and Soskice, 2018) or a general skepticism towards political demand management (Brunnermeier, James and Landau, 2016; Dullien and Guérot, 2012; Matthijs, 2016). Although our argument shares this prediction for external adjustment, it makes a different prediction for internal adjustment. Here, our argument suggests that for most types of internal adjustment, some economic interest groups will be supportive, whereas others will be opposed. Rather than representing a general opposition to internal adjustment, interest group preferences diverge on how to adjust internally.

### 4.3 Research Design: Studying Interest Group Preferences in Surplus Countries

To examine how the distributional concerns of interest groups shaped their preferences on crisis resolution strategies for the Eurozone crisis, we pursue a two-pronged, mixed-method empirical approach that uses data from an original online survey of interest groups and in-depth interviews with interest group representatives and policymakers in Germany, Austria, and the Netherlands. In the next section, we justify our case selection, describe the sample of interest groups we contacted, and provide detailed information on the design of our survey.

Our empirical analysis concentrates on Germany, Austria, and the Netherlands. We selected these cases from all Eurozone countries running a current account surplus in the years to the crisis based on two considerations. Because the attractiveness of internal adjustment depends on how well the economy is running in the first place, the first consideration is how well surplus countries' own economy did during the Eurozone crisis. Some of the surplus countries experienced robust GDP growth throughout the crisis years, whereas others faced economic problems of their own. It is plausible to assume that the situation of the national economy shapes groups' evaluation of the different crisis strategies. Measures aimed at boosting domestic demand, for example, are likely to seem much more attractive if business at home is doing poorly than if domestic markets are humming. Second, interest group support for or opposition to providing deficit countries with financial support is likely to be influenced by whether a surplus country ends up on the receiving end of international financing in the future. While some surplus countries in the Eurozone have run persistent trade surpluses for decades, others have a history of running both surpluses and deficits (Manger and Sattler, 2019). Countries that are more likely to run deficits again in the future are also more likely themselves to need some financing support in a future crisis. Interest groups in such countries, thus, might be more generous than interest groups in countries with persistent current account surpluses.

To compare interest group preferences and politics across these different contexts, we select countries that differ with regards to these two issues. Figure 4.2 plots the countries' position regarding their average growth rates between 2010 and 2014 and their net international investment positions in 2008 (i.e., prior to the crisis). Because countries with a current account surplus are by definition always capital exporters, they will over time accumulate financial assets in the rest of the world. The net international investment position—the stock of foreign assets an economy has with the rest of the world—will, therefore, be higher the longer a country has been running a current account surplus. Thus, it proxies for how long countries have been running a current account surplus.

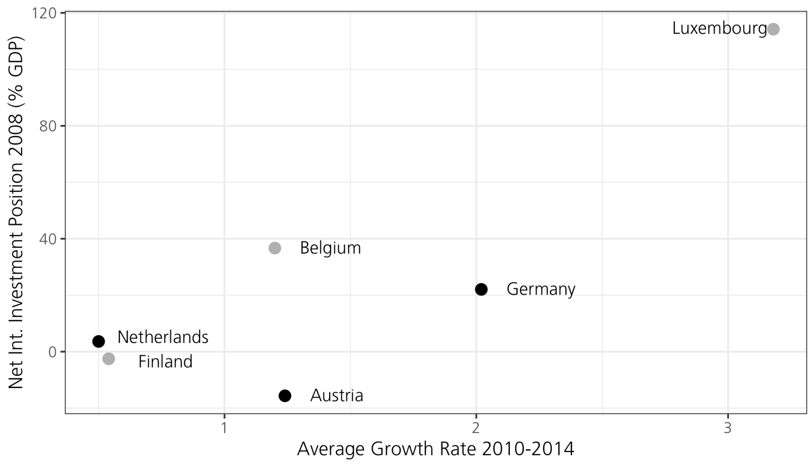



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Figure 4.2: Net international investment positions and average growth rates for Eurozone surplus countries

Figure 4.2 shows that Austria, Germany, and the Netherlands vary on both of these dimensions. Austria's economy was doing moderately well between 2010 and 2014. However, its current account had only turned positive at the beginning of the 2000s, so its international investment position remained negative until 2012. Germany showed robust growth throughout the Eurozone crisis and has had a persistent current account surplus for decades.[5] Germany is also a substantively important case, as it was one of the most prominent and powerful actors involved in managing the Eurozone crisis and was widely criticized for running massive current account surpluses. Finally, the Netherlands also had a stable current account surplus, but the country struggled with stagnating growth rates and rising unemployment during the Eurozone crisis.[6]

Much research on the role of societal interests in economic policymaking makes strong assumptions about the preferences of different interest groups, but either they do not empirically examine these assumptions (Hall, 2012; Iversen and Soskice, 2018; Nölke, 2015) or they use only broad proxies to operationalize these preferences (e.g. Frieden, 2002). We follow a different approach. Rather than inferring policy preferences on theoretical grounds, we conducted large-scale online surveys of Austrian, German, and Dutch interest groups in which we asked them about their specific policy preferences and reactions to the trade-offs inherent in crisis management. The surveys were conducted between September 2016 and October 2017—that is, after the crisis had calmed down but at a time when discussions over different financing approaches, Eurozone reforms, and macroeconomic imbalances were still ongoing in all three countries. Nonetheless, several of our questions asked respondents to answer retrospectively about their policy preferences at the peak of the crisis. To ensure that this did not systematically skew the responses, we validated survey answers with press releases, reports, and other interest group publications on similar topics between 2010 and 2015 whenever possible. For an overview for the documents we used for this validation, see section C in the supplementary materials. We did not find any evidence that interest group responses differed due to the timing of our survey.

We contacted "sectional interest groups", i.e. groups that represent the interest of a well-defined subset of societal interests (Giger and Klüver, 2016). We concentrated on interest groups that engage with economic or social policy issues and disregarded all other groups, such as environmental groups, civil rights, and religious groups. We also contacted only groups organized at the national level where most policy decisions regarding the crisis were made. Respondents were contacted via email, through three rounds of reminder emails, and finally by an individual phone call. Among the contacted interest groups, 357 interest

[5] A short exception to this was Germany's period as a deficit country in the 1990s as result of German reunification. See Manger and Sattler (2019) for a discussion.

[6] Although Luxembourg would maximize variation on these two indicators, the country's unusual and small economy limits the inferences we can draw from this case.

groups completed our questionnaire (136 from Germany, 116 from the Netherlands and 105 from Austria), resulting in response rates of 28% in Germany, 26% in Austria, and 29% in the Netherlands, which corresponds to typical response rates for interest group survey research (Marchetti, 2015). Among the interest groups who responded to our survey, 54% are employer associations, 30% are professional associations, 8% are trade unions, and 8% are social policy groups. As we show in the appendix, this distribution comes close to the overall distribution of these types of interest groups within the three countries. For ease of exposition, we present the operationalization.

We also conducted 30 in-depths interviews with interest group representatives and policymakers in Germany (13 interviews), Austria (9 interviews), and the Netherlands (8 interviews). The main goal of our conversations was to understand what motivated their preferences regarding possible policy responses to the Eurozone crisis and how they pursued these interests politically.[7] We selected groups based on their size and the importance of their members to the overall economy; we made sure to cover groups representing a wide range of sectors, including manufacturing and services, domestic- and export-oriented associations, and trade unions representing workers at different income levels. A complete list of interview partners can be found in the appendix.

Our analysis examines the preferences of economic interest groups about the management of the Eurozone crisis in surplus countries. It proceeds in three steps. The next section explores how interest groups evaluate different policy options within internal adjustment, external adjustment, and financing. We analyze not just how these preferences vary but also to what extent they are related to material considerations. Our results show that, overall, a large majority of groups opposes a Eurozone breakup and are positive towards internal adjustment, although groups strongly diverge in policy-specific preferences for internal adjustment. Moreover, most economic actors are relatively indifferent about various measures of international financing. We then turn to the inherent trade-offs of crisis management and apply the vulnerability profile framework empirically to investigate the preferences of economic interest groups when confronted with policy-specific trade-offs. We show that internal adjustment is the strategy of choice for a large majority of interest groups, especially when a reduction of the current account surplus is achieved through policies suiting their interests.

[7] The interviews in Germany took place between November 27 and December 8 2017. Interviews in Austria and the Netherlands took place between June 18 – 22 and July 02 – 06 2018.

It is only in scenarios in which all adjustment strategies are costly that financing becomes an attractive alternative. In the third step of our analysis, we finally explore the salience of the different crisis strategies and find that financing carries much less salience for interest groups than strategies aimed at macroeconomic adjustment.

### 4.4 Policy-specific preferences on Eurozone crisis management

How did surplus country interest groups evaluate the different policy options within the three general strategies—external adjustment, internal adjustment, and financing—available to resolving the Eurozone crisis? To examine this question empirically, we presented interest groups in our survey with a set of policies that were actually discussed in policy circles during the Eurozone crisis as options to achieve a rebalancing or to finance deficit states. Among these policies, we chose those policies that were actively discussed in all three of our country cases and that are general enough to remain comparable across the three countries.

Table 5.1 provides an overview of the different policies included in our survey. The possible scenarios for external adjustment all involve the breakup of the Eurozone, and we presented respondents with three variants of how such a breakup could come to pass: Eurozone exit by a deficit country such as Greece; dividing the monetary union into a "Southern" and a "Northern" Eurozone, or their own country's exit from the Eurozone—a policy that was touted, for example, by the German populist-right party Alternatives for Germany (AfD).

Regarding internal adjustment, for example socialist and social democratic parties in Austria, Germany and the Netherlands, all pushed for policies that aimed at raising the incomes of low-wage workers. We, therefore, included "higher minimum wage" as a possible adjustment policy that captures group preferences towards low-wage policies more generally. Likewise, the IMF and the European Commission repeatedly called for overhauls of the corporate tax systems in surplus countries to boost private investment. While the specific tax recommendations differed slightly across countries, we included "decreasing corporate taxes" to measure preferences towards corporate tax incentives more generally.

Policy options for financing also covered very different approaches. They included government-based financing in the form of sovereign bailouts and loans; more indirect forms of financing, such as ECB bond purchases; long-term EU-wide schemes, such as the introduc-

Table 4.1: Policy options by crisis strategy

| Internal Adjustment Policies | Financing Policies | External Adjustment Policies |
|---|---|---|
| **Public infrastructure spending** ("Expand public investment, for example in education or infrastructure.") | **Provision of bailouts** ("Provide financial assistance and loans through the European rescue funds.") | **Deficit countries leave the EMU** ("Deficit countries like Spain or Greece leave the Eurozone") |
| **Higher minimum wage** ("Increase low wages, for example by raising the minimum wage") | **European unemp. insurance** ("Introduce European unemployment insurance.") | **North/ South division** ("The EMU divides into a North and a South block with different currencies.") |
| **Decreasing VAT** ("Reduce the rate of the value added tax") | **Haircuts on public sector debts** ("Grant reliefs on debt that crisis countries' owe the [DE, AT, NL] state as a result of the European bailout packages.") | |
| **Decreasing corporate taxes** ("Reduce taxes for companies") | **Haircuts on private sector debts** ("Grant reliefs on debt that crisis countries' owed the [DE, AT, NL] private banks at the beginning of the crisis.") | |

tion of a European unemployment insurance, to a bail-in of private investors. As discussed above, the policy options for internal adjustment and financing range much more widely than policy options for external adjustment, and we presented interest groups with a selection of five different policies for both of these crisis strategies. Respondents were asked to evaluate each policy on a scale from 1 (strongly oppose) to 5 (strongly support). Interest groups' evaluations of each of these policies allow us to explore in considerable detail how they evaluated not only the overall crisis strategies available to policymakers but also the concrete policies associated with each of these policies.

We begin by analyzing interest groups' average assessment of the different policies that were discussed during the crisis as possible ways to rebalance the economy or finance deficit countries. Figure 4.3 shows the average policy support or opposition to these policies for each of the three crisis strategies in Austria, Germany, and the Netherlands. This analysis suggests that, overall, most interest groups opposed any breakup of the Eurozone, took a rather benevolent view of internal adjustment, and were quite indifferent with regards to financing. In contrast to both the ideas-based (Brunnermeier, James and Landau, 2016; Matthijs, 2016; Matthijs and McNamara, 2015) and the growth-model-based research strands (Iversen and Soskice, 2018; Steinberg and Vermeiren, 2015), which both assume a broadly

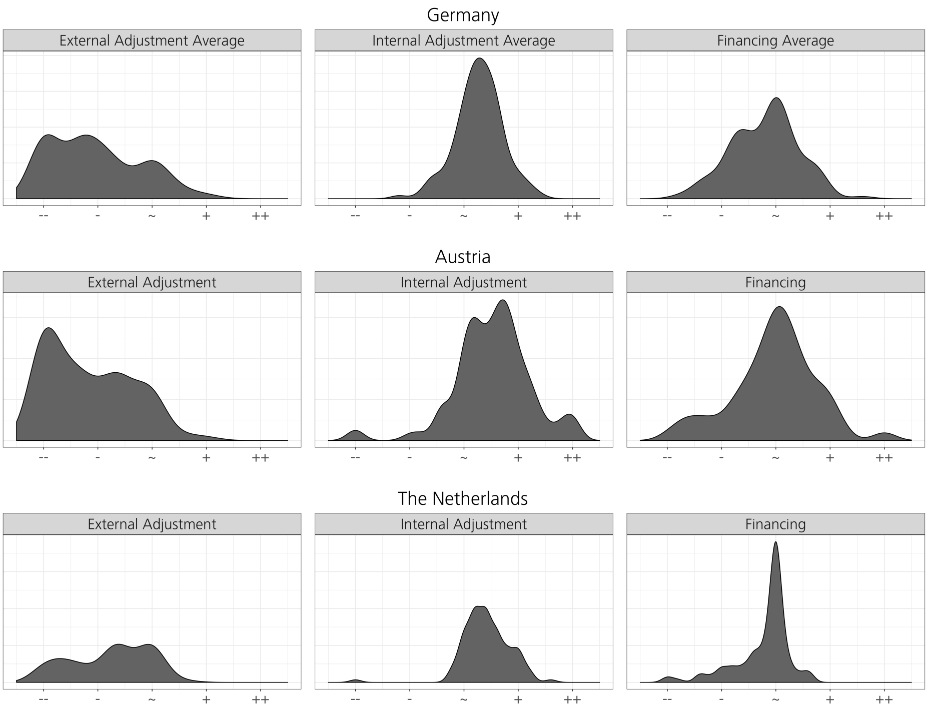



FIGURE 4.3: Average policy evaluations for the three possible crisis strategies

shared opposition to internal adjustment among surplus country interest groups, we find a generally positive attitude towards internal adjustment.

This finding is corroborated by our interviews. In Germany especially, a large number of interest groups felt that the country's large current account surplus was problematic. These groups are not only major trade unions but also a wide range of employer associations, including those representing export-oriented industries, such as the association of the metal industry (Interviews DE2; DE7; DE8). Even groups that rejected the notion that Germany's export overhang had played a role in the Eurozone crisis stated that the German economy had underperformed in terms of private and public investment in recent years and voiced their support for specific policies that would serve to counter this trend (Interviews DE3; DE6). Debates about the general effects of current account surpluses were more muted in Austria and the Netherlands. In both countries, most major economic interest groups did not perceive their national trade balances to be problematic. Discussions about the macroeconomic imbalances within the Eurozone were largely seen as a German problem; the surpluses of the Netherlands or Austria played only a minor role (Interviews AT1; AT4; NL1; NL4). However, most interest groups similarly pointed at the lack domestic demand as well as the shortage of private and public investments as major policy concerns that needed to be addressed (Interviews AT1; AT4; AT5; NL1; NL4; NL3). Instead of building a unified front in favor of preserving export surpluses, most of the actors we interviewed were in favor of some measures that would increase domestic demand and reduce current account surpluses.

While these average assessments are insightful, our argument suggests that interest groups' preferences about macroeconomic adjustment should be policy-specific. We, therefore, next turn to a more disaggregated analysis.

### 4.4.1 External Adjustment Preferences

How did interest groups evaluate different breakup scenarios for the Eurozone? Figure 44.4 displays density plots of groups' assessment of each of the three options of external adjustment. In all our analyses, we distinguish between the four main types of interest groups—employer associations, professional associations, social policy groups, and trade unions—because the material interests of these groups are likely to differ.

Our analysis shows that on average all interest groups in all three countries opposed a breakup of the Eurozone in any form, even though Dutch interest groups were slightly less opposed than Austrian and German groups. There is some variation regarding the various breakup scenarios. While groups unequivocally rejected a Eurozone exit of their own country and mostly opposed dividing the Eurozone into a Northern and a Southern block, the assessments of a deficit country exit were slightly more mixed. Nonetheless, only about 21% of all the groups in our sample stated that they would support some form of a Eurozone breakup.

These findings are consistent with qualitative evidence on interest group preferences on external adjustment. In our interviews, major employer associations and trade unions in all three countries univocally stated that their members depended crucially on the stability of the monetary union in its current form. Groups in tradable sectors mainly feared that a breakup would lead to unforeseeable exchange rate and market volatilities, disruptions on financial markets, as well as threats to European economic integration more generally. They also often mentioned the return of trade barriers as a possible long-term consequence of a Eurozone breakup (Interviews DE1; DE2; AT1; AT4; NL1).[8] However, even non-tradable

[8] For press statements confirming this position see (Habit, 2011; Inacker, 2012; Meyer, 2011; VNO-NCW, 2014).

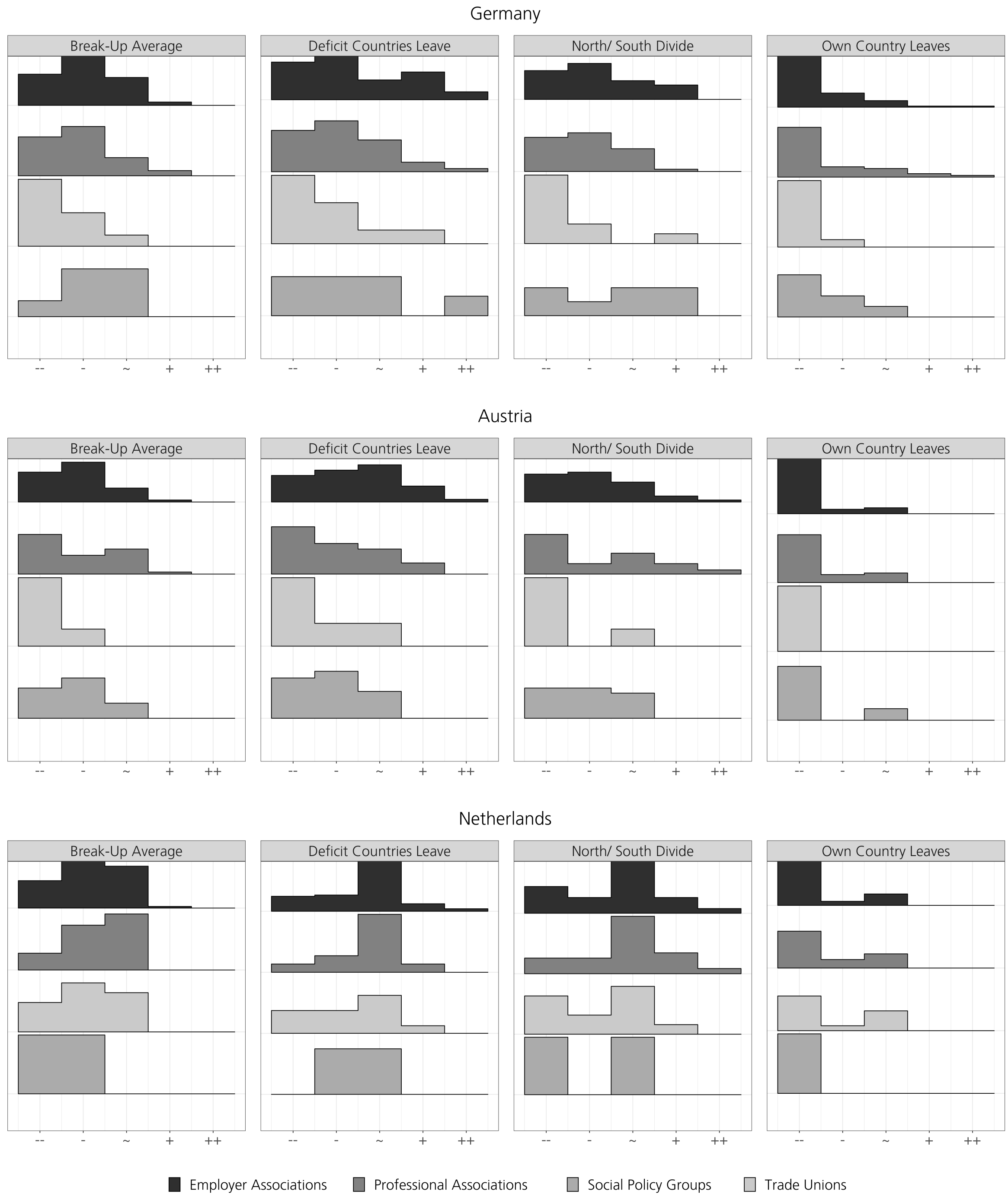



FIGURE 4.4: Interest group evaluations of different Eurozone-breakup scenarios. Density plots. Ratings range from – (strongly oppose) to ++ (strongly support).

sector interest groups, such as those focused on retail or construction, emphasized that a breakup would have extensive negative effects on their members. Main concerns were a general depression of the economic climate as well as higher credit and refinancing costs for their members due to insecurity and friction in the financial markets (Interviews DE5; NL3).

One important exemption to this general opposition to a Eurozone breakup was a potential exit by Greece. While almost all trade unions and employer associations we interviewed said that they had supported keeping Greece in the Eurozone at the beginning of the crisis—mainly due to potential contagion effects on other member states under stress—most of them also pointed out that the potential economic costs of a Grexit for their members had become negligible by 2017.

Nonetheless, the overall picture confirms research that assumes a general opposition among surplus country interest groups to external adjustment (Hall, 2018; Iversen and Soskice, 2018; Nölke, 2015). During the Eurozone crisis, an important objective of these groups was to safeguard the EMU.

### 4.4.2 Internal Adjustment Preferences

The picture is decidedly more mixed when it comes to internal adjustment. Despite the rather favorable overall assessment of internal adjustment, Figure 4.5 shows that there are clear differences in interest groups' evaluations when it comes to the specific policy alternatives. While, for example, a large majority of trade unions, social policy groups, and professional associations in Austria, Germany, and the Netherlands stated that they would support a higher minimum wage or more spending on social welfare, most employer associations were clearly opposed to such policies.

The picture looks exactly the opposite way when it comes to lower taxes for businesses. Our analysis shows that every policy is supported by some groups, but also opposed by others. The only exception is a policy of increasing public investment, which almost no interest group rejected and for which support was particularly high in Germany. These findings corroborate our argument that interest group evaluations of different internal adjustment strategies are likely to be policy-specific because the costs and benefits of internal adjustment for a socioeconomic group depend on the specific policy under consideration.

While we find a generally positive attitude towards internal adjustment, we also find a considerable degree of variation in policy-specific assessments, which results in rather polarized policy preferences regarding internal adjustment. This finding is corroborated by our interviews. All the trade unions we talked to stressed the need to increase wages—for example through a higher minimum wages, expanded coverage of the negotiated tariff

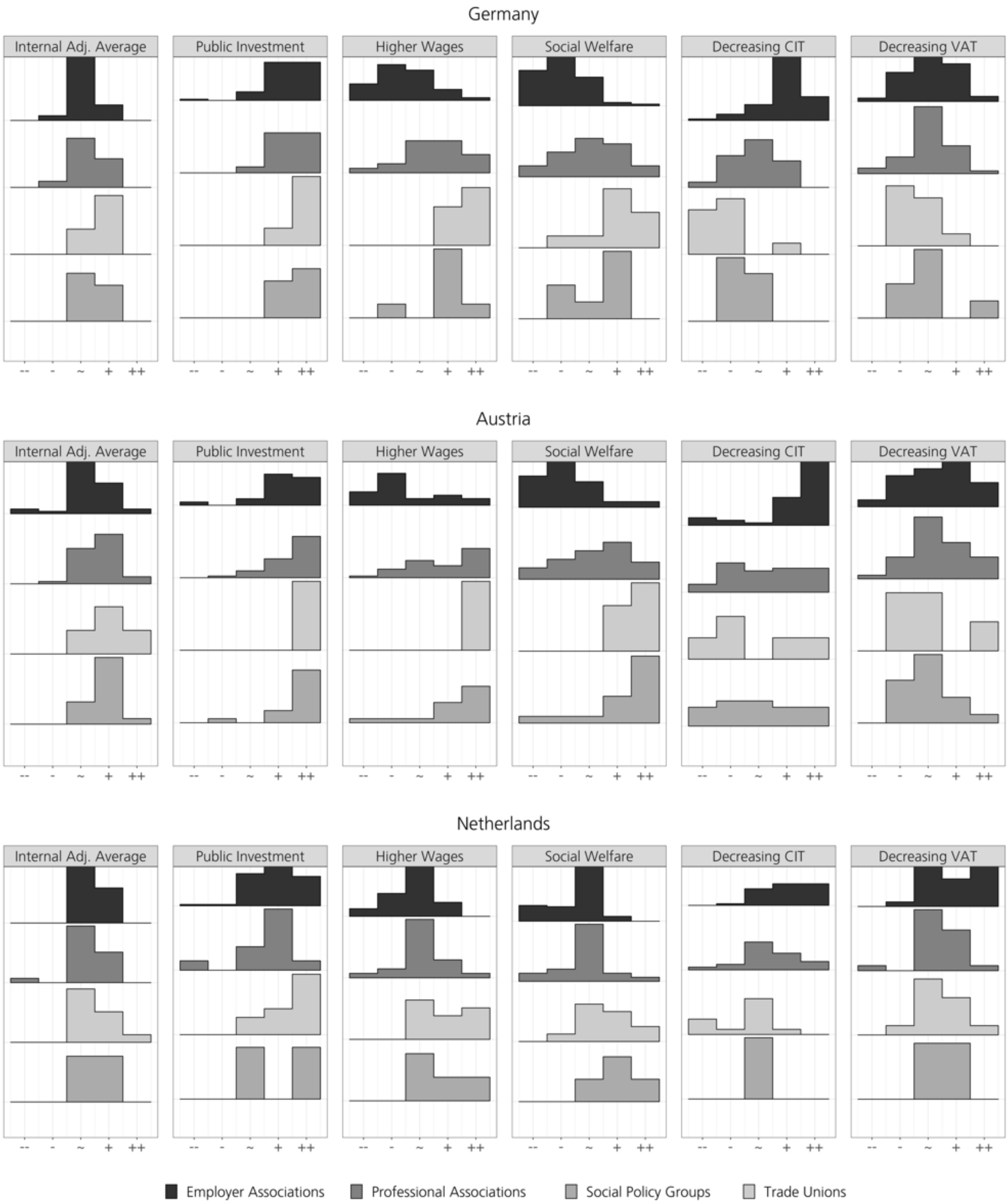



FIGURE 4.5: Interest group evaluations of different internal adjustment policies. Density plots. Ratings range from – (strongly oppose) to ++ (strongly support).

commitments, and a re-regulation of opt-out clauses and temporary employment contracts (Interviews DE7; DE8; AT4; AT5; NL4).[9] At the same time, they fiercely rejected any form of tax break for companies or any efforts to deregulate the service sector in order to stimu-

[9]See also DGB (2013); ORF (2012).

late private investments—the last one being a concern that they shared with representatives of the craft association. Many employer associations, on the other hand, emphasized the expansive effects of corporate tax cuts, the reductions of red tape in service industries, and the less regulated credit provisions (Interviews DE1; AT1; NL1).[10]. At the same time, most German industry groups had fought the introduction of the minimum wage in 2013, and employer associations in three countries said that they would lobby against further attempts to strengthen the bargaining positions of employees in wage negotiations. As a representative of a large umbrella organization put it, "of course the main employer associations, for microeconomic reasons, have to come out against such measures [such as higher minimum wage or re-regulating contracts]. But then in tripartite exchanges, trade unions say 'But that's exactly what we want.' [...] Nobody is thinking about these things in an overall economic context. So that's what makes it difficult (Interview, DE1)."

One of the most surprising findings from our survey is the strong support for public investment by almost all interest groups. This support was also evident in our interviews, where all interest groups agreed that more public investment was needed. However, opinions again diverged on what kind of public investments should be prioritized and on how these investments should be financed. While some groups stressed the need for more public services, such as investment in education and daycare, others prioritized investments in road, energy, and digital infrastructure. Regarding the financing of more investments, similar distributional conflicts arose. Whereas trade unions and craft associations demanded financing through tax money and possibly new public debt, many employer associations insisted they be financed by private-public partnerships, which would also provide new investment opportunities to large institutional investors (Interview DE13; DE8).

In sum, our analysis shows that surplus country interest groups are not per se opposed to internal adjustment. In fact, among all three potential crisis strategies, internal adjustment was the strategy that interest groups viewed most favorably on average. However, our analysis also shows that interest groups were heavily divided on how such adjustment should be achieved.

[10] See also BDI (2014); Schneider (2013); VNO-NCW (2014, 2016)

### 4.4.3 Financing Preferences

Given that interest groups were opposed to any form of a Eurozone breakup and were deeply polarized on how to achieve internal adjustment, we now turn to their assessments of the third possible crisis response: financing. Figure 4.6 shows how Austrian, German, and Dutch interest groups evaluated different forms of international transfers. As in the case of internal adjustment, we see that interest groups' assessments were once more policy-specific. The dominant financing policy pursued by surplus country governments in the Eurozone crisis—the provision emergency credits to deficit states in the form of bailouts—was viewed rather favorably and supported or at least not opposed by a majority of interest groups. In contrast, evaluations of haircuts on loans extended to deficit countries by private investors, the ECB bond buying scheme, and the introduction of an EU-wide unemployment schemes were much more contested.

However, Figure 6 also shows that groups were much more indifferent about most forms of financing than they were about the various Eurozone breakup scenarios or internal adjustment policies. A majority of interest groups stated that they neither opposed nor supported any financing option. As discussed above, this indifference may reflect the fact that financing policies can often be designed in ways that make it difficult to predict who exactly is going to bear their cost. Of course, some options produce clear-cut winners and losers, and those are the policies where we see more polarization. For example the choice to bailout crisis countries with emergency credits instead of haircuts on private sector investments clearly benefitted exposed banks in surplus countries at the expense of taxpayers. In many cases, however, it is hard to say in advance which domestic actors are going to pay the bill for interstate redistribution and when that bill will come due. Hence, interest groups have few incentives to form opinions, let alone fight, for or against, such financing policies.

## 4.5 Material interests and policy preferences

The huge divergence in interest groups' policy preferences adds to ideas-based and growth-model perspectives on Eurozone crisis politics. Both of these approaches focus mainly on factors that should unite broad coalitions of interest groups in their opposition towards macroeconomic rebalancing. In contrast, the heterogeneity of interest group's policy preferences underscores that interest groups also form policy preferences based on their material

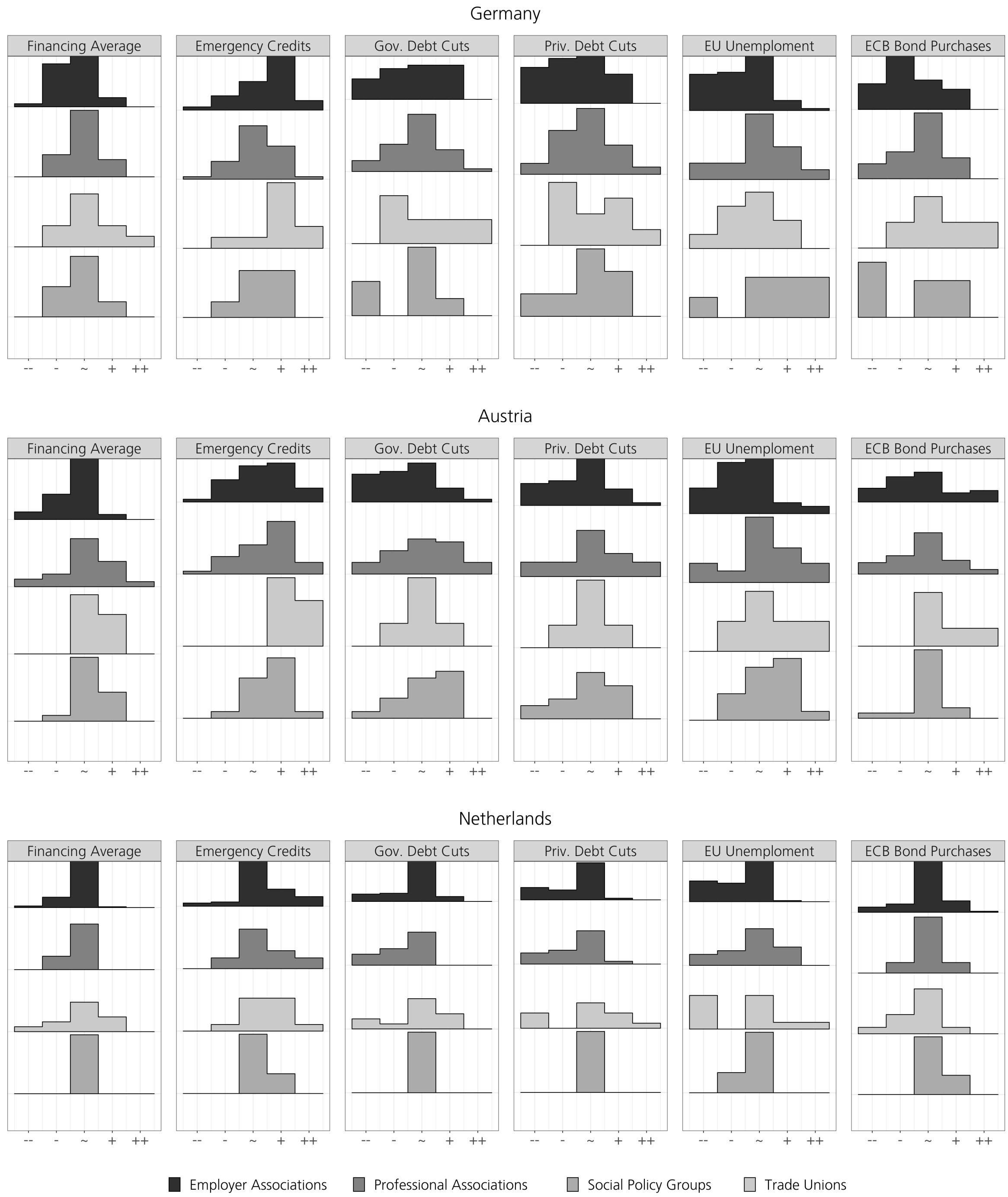



FIGURE 4.6: Interest group evaluations of different financing policies. Density plots. Ratings range from – (strongly oppose) to ++ (strongly support).

interests (Frieden, 1991; Lake, 2009; Rogowski, 1987; Walter, 2013), which thus compete with ideational and structural forces in shaping surplus-country politics in the Eurozone crisis..

To corroborate this assumption, which also underpins the theoretical approach in this book, we next examine empirically how well objective measures of interest groups' material interests explain their stated policy preferences in our online survey. Do interest groups' subjective evaluations of policies broadly correspond to some rough estimates of their objective exposure to different adjustment strategies?

For this analysis we use both broad measures of how much interest groups are likely to be helped or hurt by a macroeconomic rebalancing and information on the type of people or firms they represent to gauge their material exposure to different crisis strategies. For the former, we classify groups according to their main sector of economic activity and use this classification to collect data on two measures of exposure: interest groups' trade dependence and demand elasticity.[11] A group's trade dependence is measured as the share of the output that it exports to other countries in the Eurozone.[12] It proxies the degree to which a group would be hurt by a breakup of the monetary union. The more a group exports to other European countries, the more negatively it should be affected by the exchange rate volatility and market insecurity that is likely to follow a breakup (Frieden, 2002). For demand elasticity, we assess how much a group would benefit from the general expansion of domestic demand that internal adjustment implies. We focus on the income elasticity of demand for the goods the members of an interest group produce, because it reflects how sensitive the demand for a specific good or service is to increases in aggregate income. We construct an ordinal variable that ranges from 1 for very inelastic goods (e.g., food and tobacco) to 6 for very elastic goods (e.g., financial services and personal care activities).[13] The higher the income elasticity of demand for the main good an economic group provides, the more it should benefit from internal adjustment. The details of our coding scheme can be found in Table 4.B.2 the supplementary material.

To examine to what extent interest groups' policy preferences are related to these proxies of their material interests, we run regression analyses in which we examine how an interest group's policy evaluation is related to its exposure to these policies. Figure 4.7 summarizes

[11] We use the statistical classification of economic activities in the European community (NACE) for this purpose. At the two-digit level, this categorization scheme allows us to differentiate between 99 distinct fields of economic activity. For groups that represent actors from more than one sector, we take the unweighted averages of all the sectors present among their members.

[12] NACE-level data on both measures stems from the input-output tables provided by national statistical offices (Destatis, 2018; Statistik Austria, 2018; CBS, 2018). All variables are measured by the average values between 2010 and 2013.

[13] When people have more money to spend, the income elasticity of demand tells us how much of this money they spend to buy more of a specific good or service. We make use of several empirical studies (European Union, 2007; European Union, 2008) as well as the COICOP categorization of the UN Statistics Division to arrive at our categorization.

the main findings from thirteen OLS regression analyses (one for each policy option listed in Table 5.1). All models include all 343 interest groups that answered our survey as well as robust standard errors and country fixed effects. For the group types, we compare the effects of interest group type relative to the policy evaluations of employer associations.

Our findings in Figure 4.7 confirm that groups' policy evaluations were related to their material exposure. First, it shows that groups, which provided goods and services with higher levels of demand elasticity, evaluated internal adjustment policies more positively. Hence, the more groups benefited from an increase in domestic incomes, the more they supported internal rebalancing. Similarly, the groups' evaluation of different forms of internal adjustment also reflected the material interests of the type of members they represented. Compared to employer associations, trade unions and social policy groups were more supportive of measures to increase lower wages and social spending, whereas they oppose tax cuts, especially for private companies.

Second, material interests also underpin support for financing policies. The more groups relied on exports to other members of the Eurozone, the more positively they evaluated different options for providing deficit countries with financial resources. Interestingly, these effects were most pronounced for the option to grant debt relief for deficit countries' governments. Somewhat surprisingly, trade unions, social policy groups, and professional associations tended to evaluate some forms of financing more positively than industry groups. While some of this could reflect material considerations—for example, trade unions' support for the monetary expansion of the ECB could be interpreted as prioritizing employment over price stability—norms of international solidarity were also likely to play a role.

Finally, counter to our intuition, we do not find that trade exposed groups feel more vulnerable to different breakup scenarios than groups that focus mostly on the domestic economy. As we have seen above, this is likely to stem from the fact that all groups, independent of their market orientation, were deeply concerned about the material repercussions of external adjustment.

Taken together, these findings suggest that the interest groups' evaluations of crisis policies reflect real material considerations.

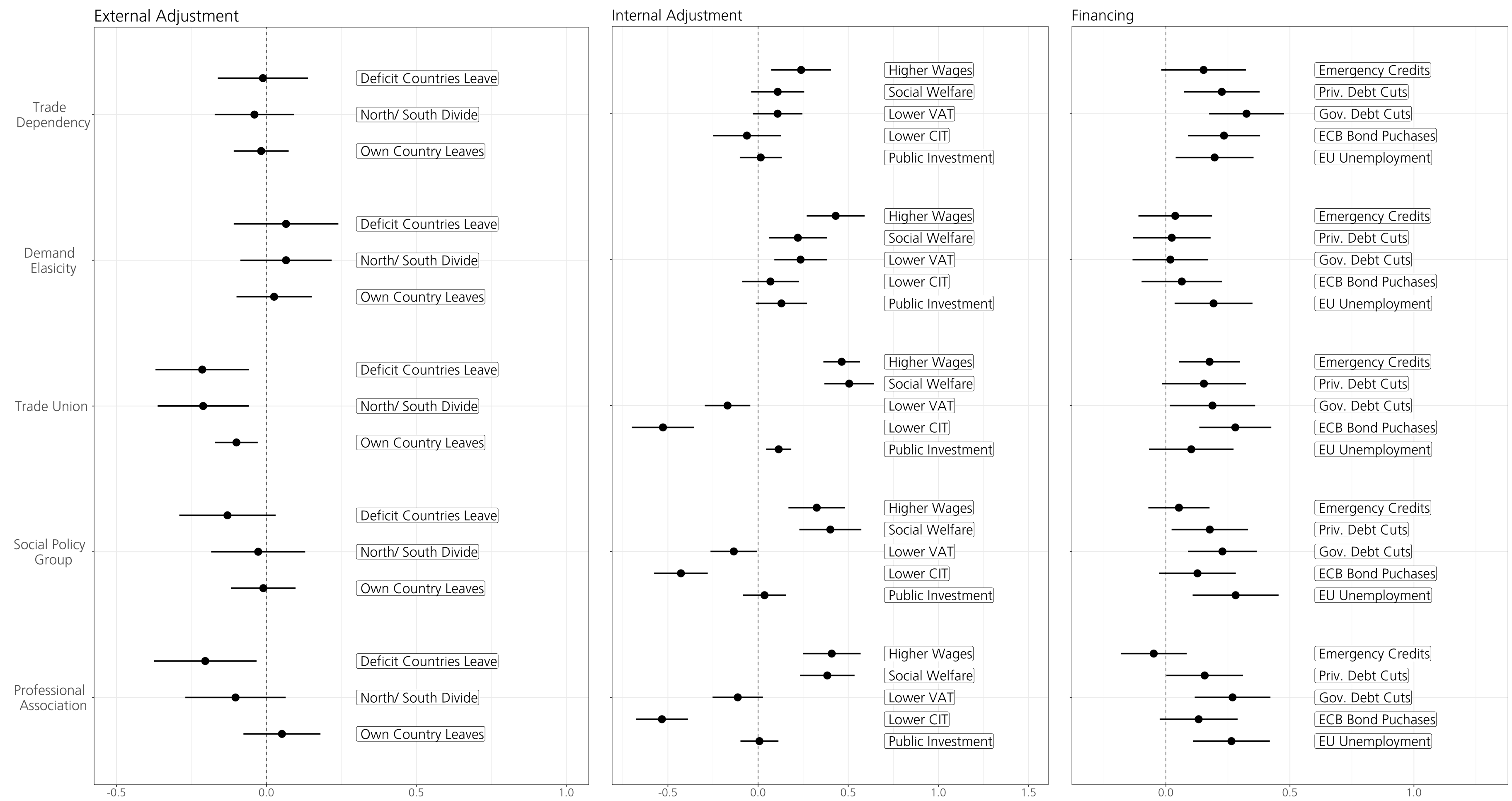
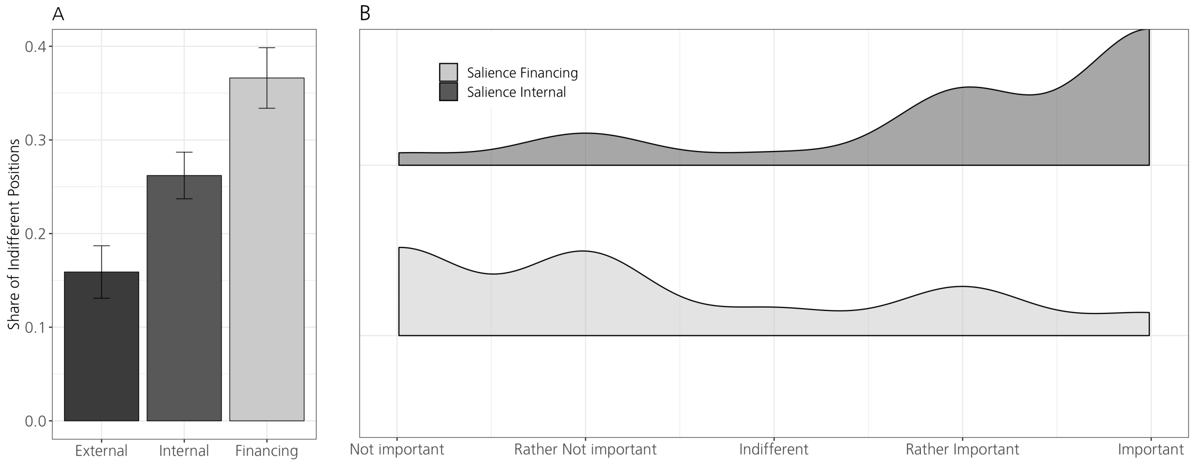



FIGURE 4.7: Effect of the interest groups' material exposure on their policy evaluations. OLS Regression coefficients. All variables are standardized; all models include robust standard errors as well as country fixed effects. The baseline category for interest group dummies is employer associations.




(A) Share of indifferent policy positions by strategy

(B) Salience of different crisis resolution strategies.

FIGURE 4.8: Policy Salience. Figure 4.8b is based on the question "How important were the following policies for the political work of your organization?"

## 4.6 Policy Salience

So far, our analysis has shown that in line with our theoretical expectations, policy preferences about possible adjustment policies varied widely—especially regarding internal adjustment and, to a lesser extent, financing—and were related to interest groups' material interests. What about policy salience? We have argued above that policies that lead to rebalancing through internal or external macroeconomic adjustment are likely to be much more salient for interest group than financing policies because the distributional effects of most forms of financing are more opaque and too long-term for interest groups to strongly care about them.

Our initial assessment of policy preferences regarding financing indeed suggested that distributional conflicts about financing were much more limited than those regarding internal adjustment. Figure 4.8a confirms this finding with a more systematic analysis. It shows boxplots of the average share of policies that interest groups stated to being indifferent about for each crisis strategy. While, on average, groups supported or rejected about 71% of the internal adjustment and 75% of the external adjustment policies included in the survey, the same was true for only about 56% of financing measures.

To explore this finding in more detail, Figure 4.8b presents further evidence in line with this characterization. To assess policy salience directly, we asked respondents how important each policy was for their organization's political work. Figure 4.8b shows a stark contrast in salience between internal adjustment, external adjustment, and financing. Almost 80% of the groups stated that policies related to internal adjustment were important or rather important for their political work. Only 19% of them said the same for financing policies, whereas the large majority characterized these policies as unimportant or rather unimportant for their political work.

Qualitative evidence confirms this picture. While most groups we interviewed supported financial rescue measures, the specificities of the bailout regime or the further steps to institutionalize transfers ranked very low on their political agenda (Interviews DE1; DE2; AT1; NL1). Even within large and encompassing employer associations—such as the Federation of German Industries (BDI), the Austrian Economic Champers (WKÖ), or the Confederation of Netherlands Industry and Employers (VNO-NCW)—there was no formal consultation about the specificities of financing policies. As a representative of a large umbrella association for business groups put it: "The potential costs of these measures were never really thought of or discussed. [...] There are simply 50 other topics that are of much greater importance to our members (Interview DE1)."[14] In line with this characterization, none of the policymakers we talked to could remember any consultations with interest groups about the nature of different financing measures (Interviews DE11; AT9; NL7).

### 4.7 Trade-Offs and difficult choices between external adjustment, internal adjustment, and financing

Until now, we have studied interest groups' evaluations and the salience of different forms of internal adjustment, external adjustment, and financing separately. Our analysis has shown that almost all interest groups opposed any form of a Eurozone breakup. At the same time, they were quite open towards an internal rebalancing of their economies but deeply divided on how such internal adjustment should be achieved, and, overall, surplus countries did show a great reluctance to adjust internally. Regarding financing, most groups were rather indifferent about different options for financing, and, in general, interstate transfers ranked low on their political agenda.

[14] The financing questions were more important to trade unions. However, here they were mainly discussed with reference to the effects of the attached conditionality to workers in deficit countries and not so much regarding the potential distributional effects in Germany.

A key argument in this book, however, is that crisis politics needs to be understood as choices among bad options, which are characterized by trade-offs. In a setting in which groups strongly disagree about the desirability of different policy options, it is hardly possible to implement forms of domestic expansion suiting everybody's interests. Understanding what drives decisions between costly alternatives is especially important in such contexts. We, therefore, now turn to a closer analysis of how interest groups responded to the trade-offs inherent in Eurozone crisis management. To examine how interest groups weighed the different policies and adjustment strategies relative to one another, we asked them to choose between different customized crisis responses that embodied these trade-offs. Respondents were asked to choose between three policy packages that correspond to the three adjustment strategies: internal adjustment (internal adjustment policies, limited financing, and no external adjustment), external adjustment (no internal adjustment, no financing, and external adjustment, i.e., a breakup of the Eurozone), and financing (no internal adjustment, extensive financing, and no external adjustment).

Because both our theoretical argument and our empirical analysis so far suggest that interest groups' choices between these options should vary by policy, especially within the internal adjustment and the financing options, we constructed two different choice sets and asked respondents to indicate their preferred policy package for each of the two scenarios. A first set included those policies that interest groups had evaluated most favorably and, thus, presented them with a setting in which trade-offs were relatively small. A second set, however, confronted respondents with a much more difficult choice; it included only bad options—that is those policies that interest groups had opposed most strongly.

To customize the choice sets, we asked interest groups not only to rate the different policies listed in Table 5.1 but also to rank these policy options within each crisis strategy from their most to their least-preferred option. We then used these rankings to build customized policy packages that reflected internal adjustment, external adjustment, and financing. Figure 4.9 shows how the different packages were presented to respondents. For each of the two choice sets, respondents were shown three hypothetical policy packages and were asked to choose one package. We use this exercise to generate two categorical variables: one that records interest groups' choice of crisis strategy in a less constrained context and one that records their choice in a highly constrained context, where interest groups are forced to choose between bad (i.e., their least preferred) policy packages.

Q: Assume that your organization would have had the choice between the following hypothetical policy packages during the Euro crisis. Which one do you think would suit the interests of your members best?

| A | B | C |
|---|---|---|
| • Provision of emergency credits to crisis countries | • No changes with regards to German economic policies | • No changes with regards to German economic policies |
| • **Highest-ranked internal adjustment policy** | • No financial support for crisis countries | • **Highest-ranked financing policy** |
| • **2nd highest-ranked internal adjustment policy** | • **Highest-ranked Eurozone break-up scenario** | • **2nd highest-ranked financing policy** |
| • All members of the Eurozone remain in the EMU | | • All members of the Eurozone remain in the EMU |

FIGURE 4.9: Customized construction of choice set for the three different crisis strategies

How did interest groups choose when confronted with these different choice sets? Figure 9 shows their choices in each of the two scenarios. On the left hand side, we see interest groups' preferred crisis strategies in all three countries when the policy packages include those policies that the interest group had previously ranked as its most preferred among the different options for internal adjustment, financing, and a breakup of the Eurozone. In contrast to much existing work that assumes that a large number of economic interest groups in surplus countries oppose policies that might undermine export competitiveness (Baccaro and Pontusson, 2016; Hall, 2012; Iversen, Soskice and Hope, 2016*b*; Steinberg and Vermeiren, 2015), we find that an overwhelming majority of groups actually favored such internal adjustment, as long as it comes in forms meeting their interests. Support for internal adjustment ranges from about 67% in Germany and the Netherlands to more than 80% in Austria. Support for financing, on the other hand, remains below 20% in both Germany and Austria and below 30% in the Netherlands. Echoing our findings above, less than 10% of the interest groups in the three countries would support a breakup of the monetary union—even if it comes in the form they rated as the least objectionable among the different options for external adjustment.

This picture changes dramatically in the highly constrained scenario, in which we asked groups to select their preferred crisis strategy among policy packages containing only bad options. The panels on the right-hand side of Figure 10 show that the popularity of internal adjustment drops substantially when the policy packages contain only the options least preferred by the interest groups. In Germany and Austria, only 30% of the respondents remain supportive of internal adjustment in this scenario, whereas in the Netherlands support drops below 20%. At the same time, external adjustment becomes even less popular. Less than 5% of interest groups in all three countries would support their least-preferred form of a Eurozone breakup in this scenario. While support for internal and external adjustment is reduced, financing becomes significantly more attractive. In Germany and Austria, it is almost as high as support for domestic expansion, and in Netherlands, it turns into the most popular crisis response. When the trade-offs are difficult and all choices are bad, interest groups also find it significantly harder to voice clear preferences. In all three countries, the modal response is "don't know"—many interest groups simply declined to choose in such a highly constrained context.

Our analysis underscores once more that support for different adjustment strategies is policy-specific. Whether or not an interest group supports internal, external rebalancing, or financing hinges on how these crisis strategies are designed. When internal adjustment comes in the form of policies they support, most groups support such a rebalancing. But when they are confronted with difficult choices among bad options, support for internal adjustment drops and financing becomes more attractive.

### 4.8 Vulnerability profiles and preferred crisis responses

Rather than exhibit a fundamental opposition to internal rebalancing of the economy, surplus country interest groups seem finely attuned to the distributive consequences of different possible crisis policies and strategies. To explore how interest groups deal with the trade-offs inherent in crisis management, we next explore how interest groups' vulnerability profiles shape how interest groups make difficult choices among bad options. As discussed above, we expect domestic economic interest groups to form their crisis preferences based on the relative net costs or benefits of internal and external adjustment and the net costs of engaging in financing. This suggests that when pressed to choose, they should opt for the policy package that benefits them the most and costs them the least. As long as groups benefit from the internal adjustment policy under consideration, we expect them to support domestic rebalancing. Financing, on the other hand, should become attractive when interest groups

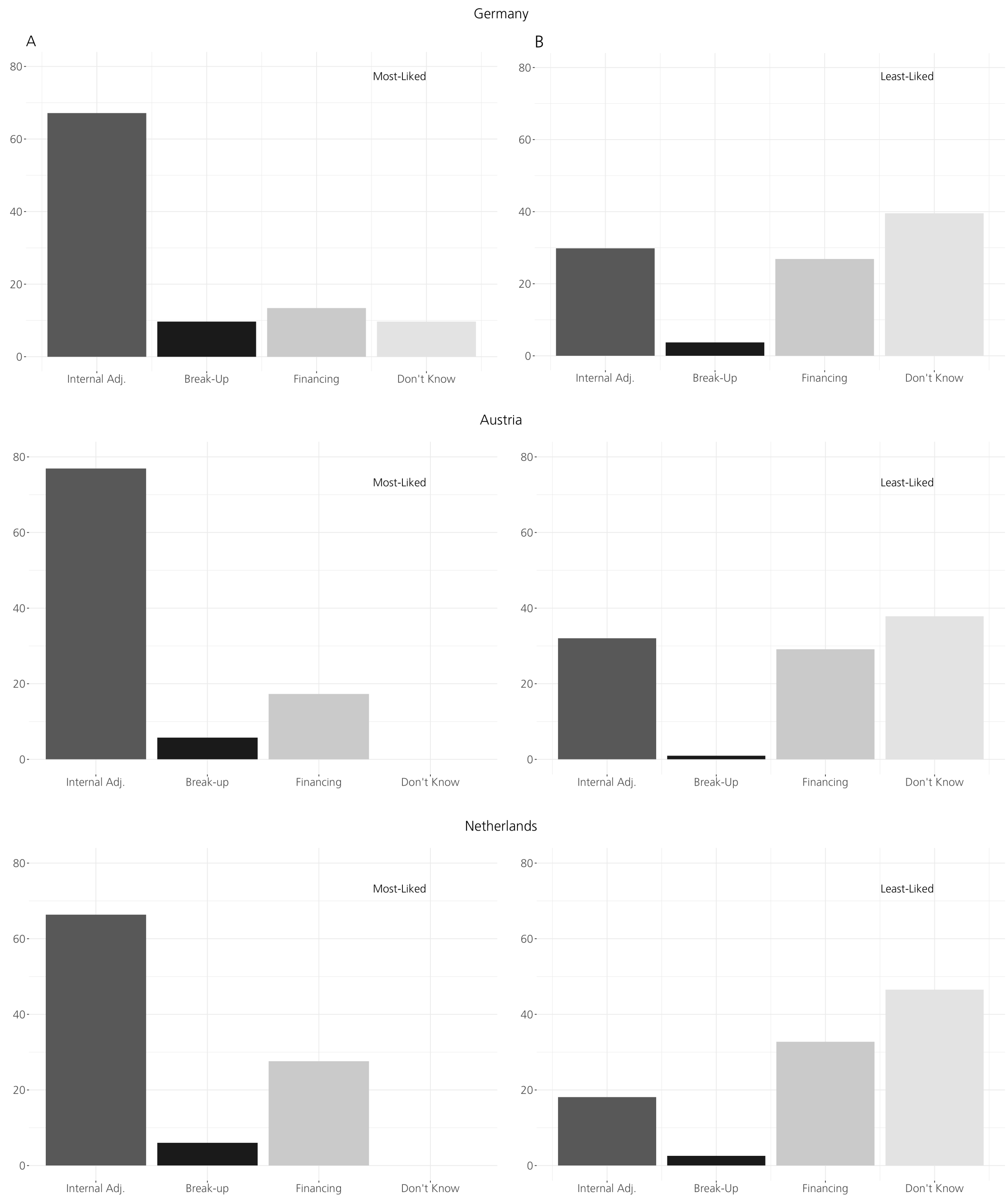



FIGURE 4.10: Choice between most-preferred (left) and least-preferred (right) crisis strategies

are confronted with trade-offs between bad options that push them into the "misery corner" of the vulnerability profile in which they are vulnerable to both the specific policies proposed for internal adjustment and a Eurozone breakup.

To explore how the interest groups' vulnerability profiles are related to how they make difficult choices, we, thus, need to construct these profiles in a policy-specific way. To proxy the interest groups' policy-specific vulnerabilities, we construct their vulnerabilities to their most-preferred and least-preferred policy options, drawing more on their ratings and rankings of the policy options shown in Table 5.1. Because our analysis has shown that interest groups' policy evaluations are related to their material interests, we use their policy evaluations of their most-preferred and least-preferred policy options, respectively, as proxies for these policy-specific vulnerabilities. We assume that groups would benefit from policies they support and are vulnerable to policies they oppose, which allows us to plot each group's vulnerability profiles for its most-preferred and its least-preferred policy options.

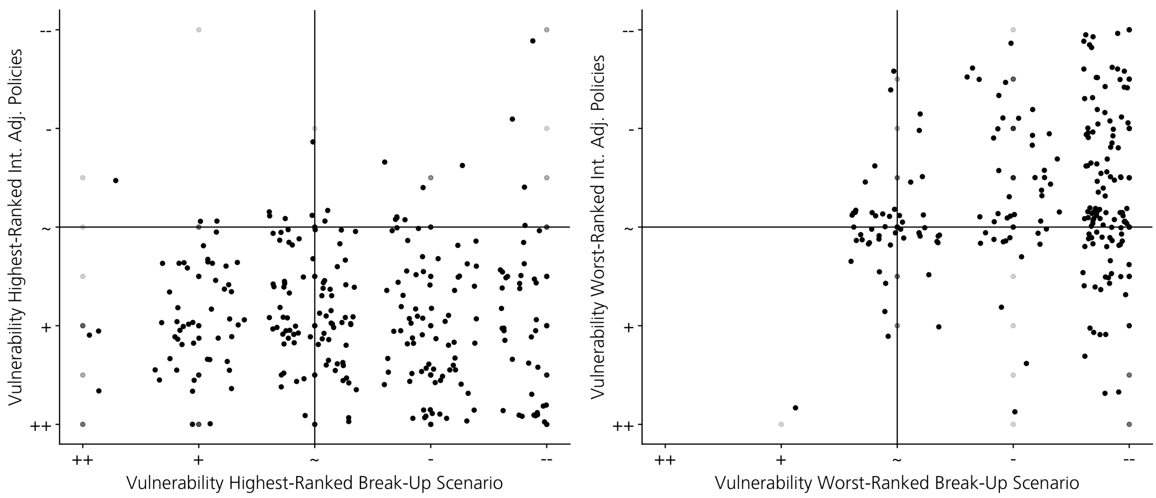



FIGURE 4.11: Vulnerability profiles for highest-ranked (left) and lowest-ranked (right) policies

Figure 4.11 shows the results of this exercise. It plots interest groups' policy-specific vulnerability to external adjustment on the horizontal axis and plots vulnerability to internal adjustment on the vertical axis. The left-hand panel shows interest groups' vulnerability profiles vis-à-vis their most-preferred types of internal and external adjustment. This panel illustrates that almost 52% are located in quadrant IV and would thus benefit from internal adjustment but be hurt by the proposed form of a breakup. Another 28% combine benefitting from internal adjustment with being indifferent about the suggested form of external adjustment. Taking these groups together, it is not surprising that almost seven out of ten interest groups support a macroeconomic rebalancing through domestic expansion in this scenario.

The picture changes drastically, however, when we examine vulnerabilities towards the interest groups' least-preferred policies for internal and external adjustment. We see not only a strong increase in those that are very vulnerable to external adjustment but also a significant increase in interest groups who are vulnerable to internal adjustment. As a result, a large number of interest groups (42%) cluster in quadrant II, the misery corner, and would be hurt by both internal and external adjustment. Not surprisingly, as we have seen in Figure 4.10 this scenario corresponds to a massive drop in support for boosting domestic demand and an increase in support for financing.

Our data also allows us to analyze the relationship between interest groups' vulnerabilities and their choices between different crisis strategies more systematically. For this analysis, we focus on choices in the constrained trade-offs scenario in which groups have to choose between crisis strategies that contain their least-preferred policies. Because not even 3% of our respondents chose a Eurozone breakup in the least-preferred scenario, we focus on analyzing interest groups' choices for internal adjustment and financing. We recode our dependent variables into two dummy variables that take the value of one if a group chose internal adjustment or financing, respectively, and zero if it did not. Because our argument suggests that adjustment decisions are driven by policy-specific vulnerabilities, our main independent variables are each group's policy-specific vulnerabilities (proxied by the respective rating) towards the least-preferred policies in the trade-off scenario. To make sure that our findings are not driven by a group's general position towards internal and external adjustment, we control for their average evaluations of all remaining policy options within each crisis strategy (i.e., all policies that are not included in the hard trade-off scenario). Because ideas-based approaches emphasize the importance of ideology, we also control for the general opinion about European integration[15] of the groups and their overall attitude towards the role of the state in the economy.[16] We also include robust standard errors and country fixed effects.

Table 4.2 presents the results of probit regression analyses in which interest groups are more likely to choose internal adjustment (models 1 and 2) and in which they are more

[15] Now thinking about the European Union, some say European integration should go further. Others say it has already gone too far. Where does your organization stand on this question? (1 "Has gone too far"; 5 "Should go further")

[16] It's a fundamental question of economic policy, whether the government should actively intervene in the economy and regulate the economy or whether economic processes should be left to the market only. Where does your organization stand on this question? (1 "Comprehensive interventions"; 5 "'No interventions at all")

Table 4.2: Probit Regression - Policy Rating And Likelihood of Chosing Adjustment Strategies

| | Adjustment Choice - Least-Liked Packages | | | |
|---|---|---|---|---|
| | Internal Adjustment | | Financing | |
| | (1) | (2) | (3) | (4) |
| Vulnerability to lowest-ranked internal adjustment policies | −0.356*** | −0.379*** | 0.226** | 0.244** |
| | (0.100) | (0.108) | (0.096) | (0.101) |
| Vulnerability to other internal adjustment policies | 0.061 | 0.074 | −0.209* | −0.199 |
| | (0.113) | (0.131) | (0.121) | (0.141) |
| Vulnerability to lowst ranked external adjustment option | 0.257** | 0.185 | 0.248** | 0.159 |
| | (0.124) | (0.138) | (0.110) | (0.127) |
| Vulnerability to other external adjustment options | 0.136* | 0.144 | 0.081 | 0.071 |
| | (0.080) | (0.089) | (0.072) | (0.075) |
| Market Liberalism | | 0.043 | | −0.008 |
| | | (0.081) | | (0.086) |
| European Integration | | 0.115 | | 0.013 |
| | | (0.086) | | (0.089) |
| Austria Dummy | −0.033 | 0.050 | 0.071 | 0.155 |
| | (0.185) | (0.204) | (0.188) | (0.201) |
| Nethelands Dummy | −0.245 | −0.113 | 0.300 | 0.306 |
| | (0.227) | (0.249) | (0.222) | (0.234) |
| McFadden R-Square | 0.14 | 0.25 | 0.12 | 0.23 |
| Observations | 333 | 282 | 333 | 282 |

*Note:* *p<0.1; **p<0.05; ***p<0.01

likely to choose financing (models 3 and 4) when confronted with difficult choices. The results show that in line with our argument, interest groups' vulnerabilities are, indeed, related to the choice of crisis strategies. The more vulnerable groups are towards the internal adjustment policies in question, the less likely they are to support domestic expansion, whereas a higher vulnerability towards external adjustment increases the propensity to support internal adjustment.[17] In contrast, interest groups' evaluations of the other internal and external adjustment policies do not have an effect. This is not surprising to the extent that these policies are not on offer, but it also suggests that the choice for internal adjustment is not driven by a general support for macroeconomic rebalancing. Interestingly, ideology has no statistically significant effect on this choice, neither regarding the interest groups' evaluation of European integration nor of state interventions more generally.

For groups that find themselves with a vulnerability profile in the "misery corner," which has a high vulnerability to external and internal adjustment, financing should be an attractive alternative. And, indeed, the more an interest group is vulnerable to internal adjustment, and to a lesser extent external adjustment, the more likely it is to choose financing as its preferred crisis strategy (models 3 and 4). As before, we do not find a significant effect of interest groups' vulnerability to those internal and external adjustment policies not included in the policy packages or ideological factors. All results remain substantially unchanged when running multinomial logistic instead of probit regressions (see Table 4.B.4 in the supplementary material).

To illustrate these results, Figure 4.12 plots the predicted probabilities of choosing internal adjustment and financing across different levels of policy-specific vulnerability towards internal adjustment. Given that virtually all interest groups opposed external adjustment, these plots assume that groups' vulnerability to external adjustment is high. Figure 4.12 shows that the probability a group prefers financing increases the more vulnerable it is to the proposed form of internal adjustment. When an interest group strongly supports all internal adjustment policies, including its least-preferred one, it will choose domestic rebalancing with a predicted probability of almost 60%, which is in line with its vulnerability profile in quadrant III. In contrast, the likelihood that the group will opt for financing stands at less than 20%. Results are reversed for interest groups in the "misery corner," who are very

[17] The latter effect is not always statistically significant. Recall that most groups opposed external adjustment, so this variable varies much less than the internal adjustment variables.

vulnerable to both the internal and external adjustment policies in the proposed policy packages. As expected, these interest groups are predicted to select internal adjustment with a probability of only about 10%, whereas the likelihood that they will opt for financing rises to over 40%.

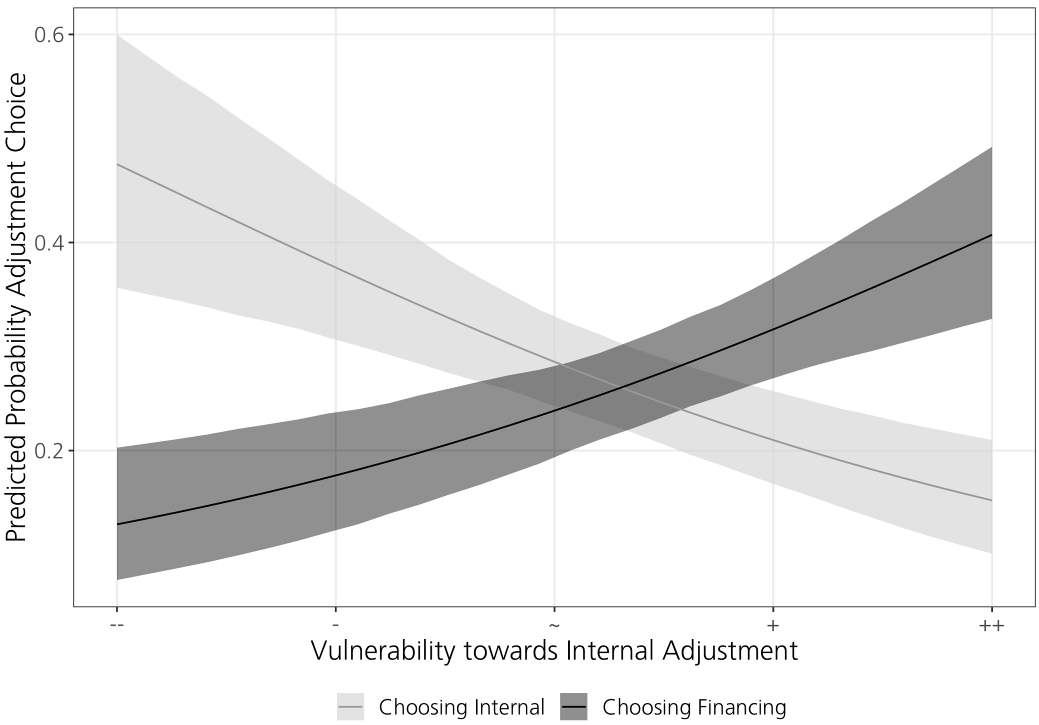



FIGURE 4.12: Predicted probabilities of choosing internal adjustment and financing at different levels of vulnerability towards internal adjustment.

Our analysis so far has shown that a majority of groups prefer internal adjustment over other possible crisis responses as long as domestic expansion is achieved through policies that serve their interests. The costs and benefits of different internal adjustment policies, however, differ across groups. Distributional conflicts about how to rebalance the economy, thus, make it a politically difficult strategy to pursue. However, opposition to specific internal adjustment policies is also associated with more support for financing, even in its unpopular variants, which is especially true, since a large majority of groups feel vulnerable to external adjustment. Together with the low salience of financing policies, this makes international transfers attractive.

## 4.9 Conclusion

Domestic economic interests have played a key role in the way surplus countries in the Eurozone approached the Eurozone crisis. Knowing how different economic interest groups positioned themselves during the crisis, what kind of adjustment strategies they supported, and which options they opposed is crucial to gain a thorough understanding of the politics of the crisis. In this chapter, we have used a wide range of newly collected quantitative and qualitative data to study the preferences of interest groups in Germany, Austria, and the Netherlands.

Our results show that different types of interest groups, such as employer associations, trade unions, or social policy groups, varied significantly in their support for and opposition to specific possible crisis policies, especially regarding internal adjustment and a to a lesser extent financing. Whereas a large majority of interest groups supported internal adjustment via policies that were to their advantage, support dropped significantly when internal adjustment involved policies to which they were opposed. At the same time, interest groups' vulnerability profiles informed their choice among crisis strategies, especially when confronted with difficult choices involving only bad options. For those interest groups who were vulnerable to both internal and external adjustment, financing turned into an especially attractive option.

Several findings stand out. First, we find that a large majority of economic interest groups reject any kind of Eurozone breakup. While there is some variation in the perception of different scenarios of external adjustment, most groups operate under the impression that any change in the composition of the monetary union would have enormous costs for their members. Just like in deficit states, the support for EMU also remained strong among surplus country interest groups throughout the crisis. Second, the lack of internal adjustment in such countries as Germany, Austria and the Netherlands is not only rooted in ordoliberal ideas, but also in distributional conflicts about the design of possible adjustment policies. Although we find strong general support for strengthening domestic demand, different groups disagree heavily about how to achieve this goal, which turns internal adjustment into a politically difficult crisis strategy. At the same time, many interest groups are willing to support financing as a way to resolve the Eurozone's problems, especially as the salience of this crisis response is surprisingly low. These findings highlight new aspects of the politics of non-adjustment surplus countries and suggest that distributional conflicts about the specific forms of internal adjustment, together with a large consensus to avoid a breakup of the union, made financing the politically most attractive alternative.

However, our results also pose a number of new questions. If interest groups were so impassionate about the costs of engaging in bailouts, debt forgiveness, or more institutionalized forms of international redistribution, why did surplus country governments, nonetheless, take such hawkish positions in international negotiations? And why did some countries, such as Austria, implement expansionary policies despite the fact that distributional conflicts about the design of such measures were similar as in the Netherlands and Germany? To answer these questions, the next chapter digs deeper into how interest group preferences interacted with public opinion, ordoliberal ideas, and the general economic climate in shaping domestic politics in surplus countries.

# Supplementary Materials

## 4.A Supplementary Material for Analysis of Interest Group Surveys

### 4.A.1 Summary Statistics Policy Ratings

Table 4.A.1: Summary Statistics Policy Ratings for Internal Adjustment, Financing and External Adjustment

| Statistic | N | Mean | St. Dev. | Min | Max |
|---|---|---|---|---|---|
| **Rating Int. Adj. Average** | 340 | 3.394 | 0.537 | 1.000 | 5.000 |
| Rating Higher Wages | 344 | 3.125 | 1.197 | 1.000 | 5.000 |
| Rating More Welfare Spending | 346 | 2.789 | 1.179 | 1.000 | 5.000 |
| Rating More Public Investment | 348 | 4.230 | 0.852 | 1.000 | 5.000 |
| Rating Lower Corporate Income Tax | 347 | 3.519 | 1.174 | 1.000 | 5.000 |
| Rating Lower Value Added Tax | 346 | 3.332 | 0.982 | 1.000 | 5.000 |
| **Rating Financing Average** | 342 | 2.826 | 0.640 | 1.000 | 5.000 |
| Rating Emergency Credits | 344 | 3.352 | 0.920 | 1.000 | 5.000 |
| Rating EU Unemployment Scheme | 345 | 2.652 | 1.071 | 1.000 | 5.000 |
| Rating Government Debt Cuts | 346 | 2.737 | 0.983 | 1.000 | 5.000 |
| Rating Private Debt Cuts | 345 | 2.661 | 1.008 | 1.000 | 5.000 |
| Rating ECB Asset Purchases | 343 | 2.758 | 0.957 | 1.000 | 5.000 |
| **Rating Break-Up Average** | 346 | 2.010 | 0.790 | 1.000 | 4.000 |
| Rating Deficit Countries leave | 348 | 2.351 | 1.062 | 1.000 | 5.000 |
| Rating North/ South Divide | 347 | 2.245 | 1.083 | 1.000 | 5.000 |
| Rating Own Country leaves | 347 | 1.444 | 0.808 | 1.000 | 5.000 |

## 4.B Supplementary Material for Material Exposure Analysis

### 4.B.1 Coding Scheme Group-Level Demand Elasticity

The concept of income elasticity of demand measures, to what degree a rise in an economy's aggregate income translates into higher demand for specific goods and services. The main source of information for this coding scheme is the Classification of Individual Consumption According to Purpose (COICOP) compiled by the United Nations Statistics Division. At the top level, this classification differentiate between 14 different areas of household and government consumption expenditures and the order of these categories are designed to "broadly reflect differences in the responsiveness of expenditures to changes in household income, known as income elasticity of demand." (UN Statistical Division, 2011). To correctly

Table 4.B.2: Coding Scheme for Demand Elasticity Scale.

| Ordinal Category | COICIO Coding | Products |
|---|---|---|
| Very Inelastic (1) | Necessities<br>Category (1) – (3) | - Standard food and non-alcoholic beverages<br>- Alcoholic beverages and tobacco<br>- Clothing and footwear<br>- Other necessities |
| Inelastic (2) | Wholesale & Primary Products<br>Category (1) – (4) | - Rentals for housing<br>- Maintenance and repair of housing necessities<br>- Water & Electricity supply<br>- Wholesale trade, transport and logistics<br>- Unprocessed, basic pro |
| Rather inelastic (3) | Housing & Health<br>Category (5) – (6) | - Furniture and furnishings<br>- Household equipment, textiles and appliances<br>- Medical appliance and equipment<br>- Outpatient hospital services<br>- High-end financial services *<br>- Provision of security and other basic public goods *<br>- Marketing and Advertisement * |
| Rather Elastic Demand (4) | Transport & Communication<br>Category (7) – (8) | - Private transport (vehicles and transport services)<br>- Specialized food products *<br>- Telecommunication<br>- Private and public construction work*<br>- Processed industrial goods |
| Elastic Demand (5) | Recreation & Education | - Durables for recreation and culture<br>- Recreational services<br>- Financial services *<br>- Education expenditures |
| Very Elastic Demand (6) | Tourism | - Personal care *<br>- Tourism<br>- Restaurants and accommodation<br>- Miscellaneous services |

* Marks categories that were ordered based on the empirical findings in European Commission (2007).

summarize the COICOP top level categories into broader a ordinal scale and to include industries not included in this categorization, we complement the order with empirical information compiled by the European Union (European Commission, 2007). Based on these sources, we designed a 6-scale ordinal variable from 1 (highly inelastic income elasticity) to 6 (highly elastic income elasticity). Table 4.B.2 gives an overview of the final coding scheme.

### 4.B.2 Summary Statistics Material Exposure and Controls

Table 4.B.3: Summary Statistics Material Exposure and Controls

| Statistic | N | Mean | St. Dev. | Min | Max |
|---|---|---|---|---|---|
| Export Dependence | 333 | 4.296 | 6.065 | 0.000 | 30.745 |
| Income Elasticity of Demand | 333 | 3.762 | 1.428 | 1.000 | 6.000 |
| Pro-European Attitudes | 294 | 3.439 | 1.036 | 1.000 | 5.000 |
| Pro-Market Attitudes | 294 | 3.078 | 1.123 | 1.000 | 5.000 |

### 4.B.3 Supplementary Material for Modeling Adjustment-Strategy Trade-Offs

To model how the trade-offs groups make between different adjustment strategies interact with their (subjective) policy-dependent vulnerabilities, we ask our interest groups to indicate their preferred policy package from a choice of three stylized adjustment packages. This leaves us with an unordered categorical dependent variable which lists each groups' preferred adjustment strategy in different policy-scenarios.

For the ease of interpretation, we transform this variable into a dummy indicating whether a specific adjustment strategy was chosen or not in our main analyses. As a robustness check, we also analysis this variable in its original form. Table A3.1 shows the results of a multinomial logistic regression for the choice between individual adjustment strategies in the least-liked policy scenario. The baseline category in each model is internal adjustment. The substantial findings of the main analysis remain unchanged. Relative to internal adjustment, groups become more likely to pick external adjustment, financing and importantly also "don't know" the more vulnerable they feel to the specific forms of internal adjustment we present to them in the constrained choice.

This section lists all documents, which we used to validate answers of a subset of respondents that participated in our online survey. Sources include press releases, parliamentary statements, interviews, articels and other secondary sources. All web sources were last visited on April 13, 2019.

Table 4.B.4: Multinomial logistic regression for adjustment choices.

| | *Dependent variable:* | | | | | |
|---|---|---|---|---|---|---|
| | External Adjustment | Financing | Don't Know | External Adjustment | Financing | Don't Know |
| | (1) | (2) | (3) | (4) | (5) | (6) |
| Vulnerability to lowest-ranked internal adjustment policies | 1.637*** | 0.630*** | 0.301** | 1.459** | 0.802*** | 0.361** |
| | (0.500) | (0.166) | (0.151) | (0.637) | (0.193) | (0.174) |
| Vulnerability to other internal adjustment policies | 0.441 | −0.388 | 0.020 | 0.605 | −0.404 | −0.084 |
| | (0.520) | (0.249) | (0.228) | (0.697) | (0.288) | (0.272) |
| Vulnerability to lowest-ranked external adjustment option | −0.991* | 0.017 | −0.579** | −0.272 | −0.022 | −0.384 |
| | (0.528) | (0.279) | (0.227) | (0.796) | (0.298) | (0.248) |
| Vulnerability to other external adjustment options | −0.862*** | −0.216* | −0.357*** | −1.544*** | −0.122 | −0.337** |
| | (0.265) | (0.129) | (0.119) | (0.554) | (0.163) | (0.154) |
| Market Liberalism | | | | −1.652*** | −0.139 | −0.185 |
| | | | | (0.608) | (0.179) | (0.172) |
| European Integration | | | | −0.212 | −0.102 | −0.120 |
| | | | | (0.626) | (0.168) | (0.161) |
| Austria Dummy | | | | −0.862 | 0.262 | −0.242 |
| | | | | (1.333) | (0.406) | (0.390) |
| Netherlands Dummy | | | | −2.466 | 0.646 | 0.048 |
| | | | | (1.584) | (0.508) | (0.477) |
| Akaike Inf. Crit. | 750.089 | 750.089 | 750.089 | 662.798 | 662.798 | 662.798 |

*Note:* *p<0.1; **p<0.05; ***p<0.01

"Internal Adjustment" serves as the baseline category. All models include robust standard errors.

## 4.C Supplementary Material for Survey Validation

This section lists all documents, which we used to validate answers of a subset of respondents that participated in our online survey. Sources include press releases, parliamentary statements, interviews, articels and other secondary sources. All web sources were last visited on April 13, 2019.

### 4.C.1 External Adjustment

- “'Offener Brief von BDI, BDA, DIHK und ZDH an alle Abgeordneten des Deutschen Bundestages Entscheidung über die Erweiterung des europäischen Rettungsschirmes”, 22.09.2011, https://www.zdh.de/fileadmin/user_upload/presse/Pressemeldungen/2011/110922_Offener%20Brief.pdf
- “BDI Präsident - Grexit wäre riesiges Problem für griechische Wirtschaft”, Pressemitteilung, 29.06.2015, https://bdi.eu/artikel/news/grexit-waere-riesiges-problem-fuer-griechische-wirtschaft/
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- “Leitl für Verbleib Griechenlands in Eurozone”, Niederösterreichische Nachrichten, 24.05.2012, https://www.noen.at/niederoesterreich/politik/leitl-fuer-verbleib-griechenlands-in-eurozone-anleihen-deutschland/eu-euro-finanzen-griechenland-schulden-waehrung-4930976
- “Leitl begrüßt Beschluss des Euro-Gipfels: Europäische Solidarität Ja, aber nur gegen Reformen”, Wirtschaftskammer Österreich, 13.07.2015, Pressemitteilung, https://www.ots.at/presseaussendung/OTS_20150713_OTS0079/leitl-begruesst-beschluss-des/euro-gipfels-europaeische-solidaritaet-ja-aber-nur-gegen-reformen
- “ÖGB-Bundesvorstand: Solidarität mit griechischen KollegInnen”, Österreichischer Gewerkschaftsbund, 23.03.2010, Pressemitteilung http://www.glb.at/article.php/20100323155219669
- “Industrie: Europa macht auch Österreich stärker”, Industriellenvereinigung, Positionspapier, 11.12.2014, https://www.iv.at/de/themen/europapolitik/2014/industrie-europa-macht-auch-osterreich-starker.
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# Chapter 5

# Crisis Politics in Surplus Countries

## with Stefanie Walter and Ari Ray

**Abstract**

This investigates how distributional conflicts between economic interest groups interacted with the preferences and priorities of voters and political elites in shaping crisis outcomes in surplus countries. Leveraging public opinion data, qualitative evidence and information gathered in 30 interviews with policymakers and group representative for a comparative case study, we analyze why surplus-country governments remained hesitant towards bailouts and alternative financing and why –- even though interest group conflicts about internal adjustment policies looked very similar –- Germany, Austria and the Netherlands varied in the extent to which they engaged in domestic expansion during the crisis. We show that gridlock amongst interest groups about how to adjust internally is especially likely to result in non-adjustment in contexts in which voters give little priority to boosting domestic demand and domestic political elites are able to design crisis responses in concordance with their own ideological convictions. However, in contexts in which the domestic economic climate makes economic reforms become a politically salient issue, policymakers have large incentives to overrule the gridlock amongst interest groups. As a result, even highly export-oriented countries implement measures that boost domestic demand and lead to a meaningful re-balancing of the current account.

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## 5.1 Introduction

Why have surplus countries been so unwilling to carry a larger share of the adjustment burden in the Eurozone crisis? In the previous chapter, we showed that domestic distributional conflicts among interest groups were a key factor impeding internal rebalancing in core countries. Based on the first systematic empirical study of interest group preferences in Austria, Germany, and the Netherlands, we showed that although most interest groups supported internal adjustment in the abstract, they were deeply divided on how to achieve it. At the same time, they also agreed that a breakup of the monetary union should be avoided, but were much less opposed to financing. Moreover, this structure of interest group preferences was very similar in all three surplus countries under investigation. We therefore concluded that this constellation of interest group preferences turned financing coupled with very limited domestic adjustment into the politically most expedient strategy for surplus country policymakers.

However, this conclusion seems at odds with two characteristics of surplus country policy responses to the Eurozone crisis. First, international transfers were not at all seen as "politically expedient" by policymakers. Rather, surplus countries, and especially Germany, were initially quite hesitant to provide bailouts and emergency loans (Sandbu, 2015; Schneider and Slantchev, 2017). Throughout the crisis, they rejected most calls for more extensive transfers or the establishment of more permanent risk-sharing mechanisms at the European level and insisted that any financial support was granted only in exchange for harsh fiscal cuts and deep structural reforms in recipient countries (Armingeon and Cranmer, 2018; Schimmelfennig, 2015; Wasserfallen and Lehner, 2018). A second puzzle emerges from the fact that despite a similar structure of interest group preferences, Germany, Austria, and the Netherlands differed substantially in the extent to which they engaged in internal adjustment during the crisis. Despite enormous international pressure, successive German governments did little to expand domestic demand. Austria, on the other hand, implemented a surprisingly large range of policies to strengthen domestic consumption and investment. Finally, instead of boosting domestic demand, the Dutch government initially implemented contractionary (rather than expansionary) policies and did very little to reduce the country's rapidly grow-

This chapter is also published as Chapter 7 in a joint book manuscript with Stefanie Walter, Ari Ray and Raphael Reinke, which is forthcoming at Oxford University Press (Walter et al., 2019) ing current-account surplus. If interest group preferences were similar in all three countries, what explains these differences?

To address these questions, this chapter takes a closer look at the politics of crisis management in these three surplus countries. We argue that to understand surplus country crisis policies, we also need to take into account the role of voters and how their preferences about all three available crisis strategies – internal adjustment, external adjustment, and financing – interacted with interest group pressures to shape the policy decisions made by governments. A wide range of authors have emphasized that public opinion played an important role in shaping Eurozone crisis politics (Bechtel, Hainmueller and Margalit, 2017; Beramendi and Stegmueller, 2016; Howarth and Rommerskirchen, 2013; Schneider and Slantchev, 2017). This chapter builds on this work and provides a systematic analysis of how domestic voters in general evaluated the different forms of internal adjustment, external adjustment, and financing, how their preferences interacted with those of organized interests, and how contextual factors determined whether voters or interest groups had more influence on the way surplus country governments approached the management of the crisis.

We argue that both interest groups and voters shaped crisis outcomes but that their vulnerability profiles and preferences differed substantially. Given these differences, issue salience was a key factor determining whether interest group politics or public opinion had a greater influence on governments' choices between different forms of external adjustment, internal adjustment, and financing. Although both voters and interest groups opposed a breakup of the monetary union, voters were much more skeptical about most forms of international transfers than were interest groups. Given the high salience of financing issues in national debates and electoral campaigns, this skepticism trumped the more open stance of interest groups and led surplus country governments to adopt very restrictive positions in international negotiations. At the same time, most voters were very open to measures that would stimulate the domestic economy, whereas interest groups were gridlocked and could not agree on how internal adjustment should be pursued. As long as good economic conditions reduced the salience of domestic economic reforms, this gridlock among interest groups meant that neither voters nor organized economic interests strongly pushed for internal adjustment. In this context, governments had ample room to follow their own ideological economic convictions or simply focus on other policy areas which largely resulted in non-adjustment. However, in contexts in which the state of the domestic economy became a salient issue, the public's support for internal adjustment led policymakers to disregard both interest group conflict and their own ideological reservations against state expansion and to engage in certain forms of internal rebalancing.

We conduct comparative case studies of crisis politics in Germany, Austria, and the Netherlands and consider a wide range of quantitative and qualitative evidence to examine this argument in detail. Our analysis proceeds in two steps. First, we draw upon a rich set of available public opinion data that allows us to trace how voters in surplus countries evaluated different policies that fell into the categories of internal adjustment, external adjustment, and financing. Based on this analysis, we show that voter preferences were remarkably similar across the three countries but that their preferences differed substantially from those of surplus country interest groups. Second, we conduct in-depth case studies of Eurozone crisis politics in our three surplus countries. Building on existing studies of the interplay between voters and interest groups, we use evidence from over 30 in-depth interviews with policymakers and interest group representatives, numerous primary sources, and a rich set of existing academic studies to trace the dynamics and contextual factors that determined whether voters or interest groups were more influential in guiding how policymakers approached different crisis strategies.

Overall, our analysis shows that given the broad opposition of both voters and interest groups, external adjustment never became a politically viable option for surplus countries. Vocal and clear opposition from voters in all three countries blocked the route towards more encompassing financing approaches. Finally, more accommodating economic policies were pursued only in Austria, where the salience of the state of the domestic economy made expansionary policies electorally expedient and led the government to force economic interest groups to accept domestic reforms.

### 5.2 Voter Preferences about How to Resolve the Eurozone Crisis

Our book's central premise is that a full understanding of the politics of the Eurozone crisis requires an understanding of how key societal actors and policymakers evaluated all potential crisis responses, including those not chosen. For surplus countries, these options were threefold: first, external adjustment in the form of a breakup of the monetary union, second, internal adjustment via a boost to domestic demand that would increase imports and domestic inflation, and third, financing the current-account deficits of countries in the Eurozone's deficit countries through financial transfers. In the previous chapter, we showed that interest group preferences about the desirability of each of these strategies differed considerably.

We now turn to voters and examine how surplus country voters evaluated these different policy options for managing the crisis, focusing on the same three surplus countries (Austria, Germany, and the Netherlands). To generate a comprehensive picture of voters' policy preferences, we combine data from multicountry surveys, such as the Eurobarometer, with a large number of national surveys that allow us to gauge voter preferences with respect to more specific issues in the domestic arena and as well as to trace the trajectory of public opinion over time. We first discuss voter preferences regarding each crisis strategy, starting with their positions on external adjustment and moving on to their positions on domestic rebalancing and finally financing. We then draw together this evidence and discuss what it means in the context of the book's vulnerability profile framework. We find that voters largely opposed a breakup of the monetary union, were quite supportive of a wide array of measures that could have contributed to internal adjustment, and remained deeply skeptical of virtually any form of international financing.

### 5.2.1 External adjustment: Surplus country voters and a breakup of the Eurozone

How did surplus country voters evaluate external adjustment? How did they view different scenarios of how the Eurozone might break up? To answer these questions, we explore three aspects of public opinion about the Euro in our three surplus countries: the public's overall support for the Euro, voters' support for their own country's exit from the common currency, and the public's views about an exit of individual deficit and debtor countries from the Eurozone. , In line with existing research (Hobolt, 2016; Hobolt and Leblond, 2013; Roth, Jonung and Nowak-Lehmann, 2016)), Figure 5.1 shows that an overwhelming majority of voters in surplus countries viewed the Euro positively and retained this positive view of the common currency throughout the crisis. On average, about 68% of voters in Germany, 65% in Austria, and 60% in the Netherlands stated that overall the Euro was a good thing for their country. That said, there was a sizeable increase in the share of surplus country voters who believed that the Euro was a bad thing for their country between 2010 and 2013, when the Eurozone crisis peaked. Nonetheless, throughout the crisis those with a generally positive view of the Euro remained the clear majority in Germany, Austria, and the Netherlands over the entire period.

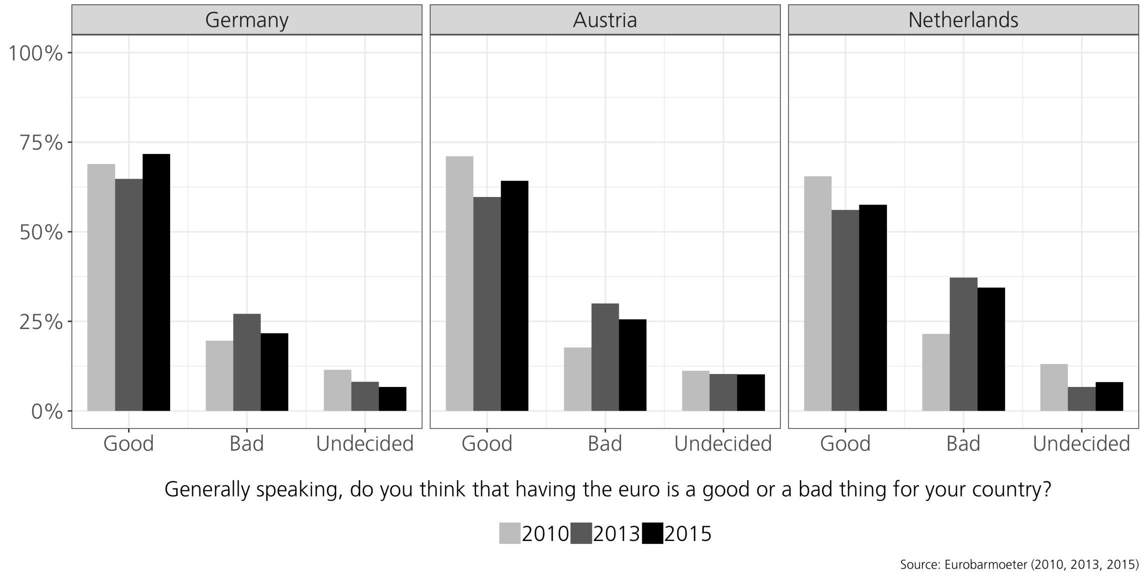


FIGURE 5.1: Overall Evaluation of the Euro between 2013 and 2015

This positive of evaluation of the Euro was also mirrored by the fact that a clear majority of surplus country voters wanted their respective countries to keep the Euro. A wide range of studies has emphasized that Euroskepticism in Northern Europe increased throughout the crisis (de Vries, 2018; Hobolt, 2016; Braun and Tausendpfund, 2014). Nonetheless, this did not translate into broad support for an exit from the common currency. Various national surveys show that those who actually wanted their country to leave the Eurozone remained the clear minority. Yet that minority was not negligible, and it was much more pronounced than among interest groups. For example, every third respondent in both a 2011 survey in the Netherlands (Maurice-De-Hond, 2012) and a 2012 survey in Austria (OGM, 2012) stated that their country should abandon the Euro and return to a national currency.[1] And in Germany, every fourth respondent favored a German exit from the Eurozone in 2013 (Jung, Schroth and Wolf, 2013). Importantly, however, this support for a national withdrawal from the common currency was more concentrated among supporters of far-right parties such as the

[1] In the Netherlands, 32%; in Austria, 35%.

Alternative for Germany (AfD), the Freedom Party of Austria (FPÖ), and the Dutch Party for Freedom (PVV). In contrast, 79% of those voting for the government parties Christian Democratic Union (CDU) and Free Democratic Party (FDP) in Germany in 2013, and 65% of those voting for the People's Party for Freedom and Democracy (VVD) and the Labor Party (PvdA), which governed the Netherlands in 2011, wanted to remain in the Eurozone. To the extent that policymakers pay particular attention to the preferences of their own party's voters (Walter, 2016), this means that surplus country governments confronted voters that overwhelmingly supported a continuation of their country's membership in the Eurozone.

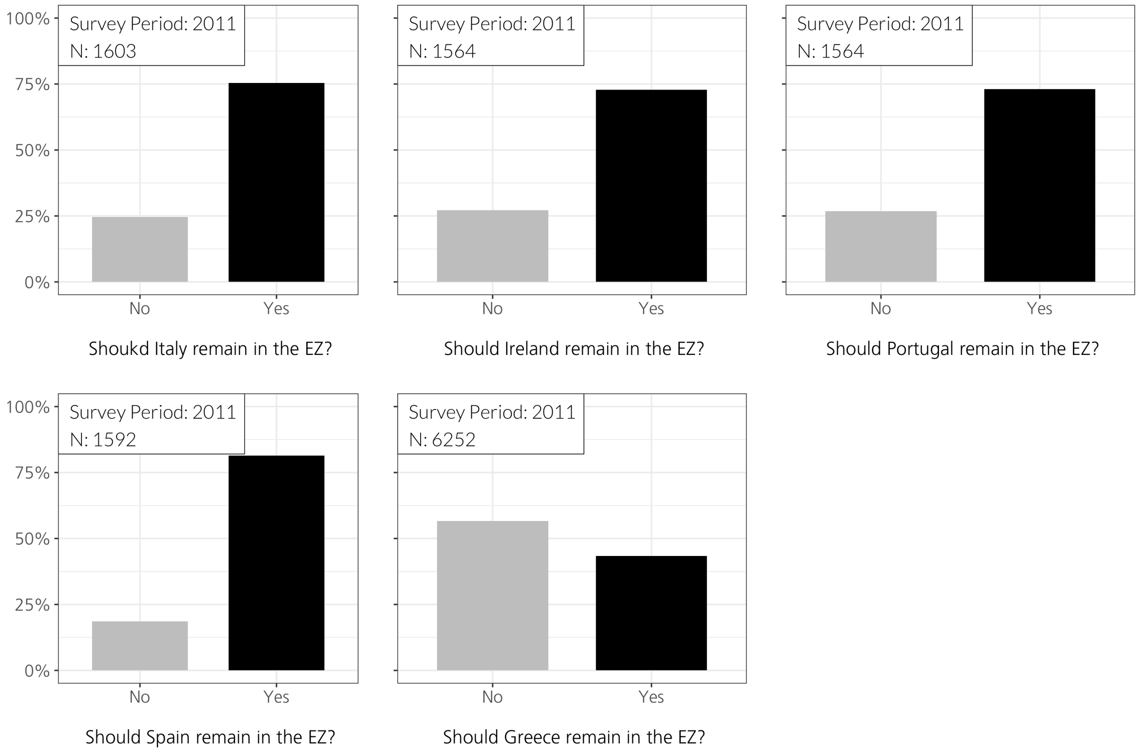


FIGURE 5.2: Should Crisis Countries Remain in the Eurozone? Responses from Germany. Source (Jung, Schroth and Wolf, 2013)

Overall, voters in surplus countries also opposed an exit of other countries from the Eurozone. Rather than supporting an "external adjustment through the backdoor" by allowing or asking deficit countries to leave the Economic and Monetary Union, surplus country voters exhibited a strong aversion to such proposals. The best data available on this issue stems from a July 2011 poll in Germany. Figure 5.2 shows that a large majority of German respondents supported the continued membership of almost all crisis countries in the common currency. Greece is the only case in which opinions on a potential exit from the Eurozone were more divided. But even in the case of Greece, there was not a clear popular push for Grexit. In 2012, a slight majority (53%) of German respondents stated that Greece should abandon the common currency.[2] This sentiment remained quite stable over time, and the number of Grexit supporters did not even change during the spectacular negotiations about the third bailout in the summer of 2015 (Forschungsgruppe-Wahlen, 2016). Surveys from Austria and the Netherlands point in a similar direction. In the Netherlands, supporters of a Grexit varied around 45% throughout the crisis period (Maurice-De-Hond, 2011, 2012, 2015). In Austria, the share of citizens that supported a Grexit actually decreased throughout the crisis. In 2012, more than 60% of Austrian respondents – a clear majority – were in favor of Greece leaving. However, by 2015 the share had significantly decreased to 45% (OGM, 2015).

Our analysis thus leads us to conclude that in the Eurozone's three major surplus countries, public support for external adjustment was quite limited. Even though sizeable minorities supported a breakup of the monetary union in one form or another, this support was concentrated among those who voted for populist-right opposition parties. The parties in government, in contrast, were confronted with voters who – in line with surplus country interest groups – overwhelmingly rejected external adjustment.

#### 5.2.2 Internal adjustment: Public opinion on domestic rebalancing

What did public opinion on internal rebalancing look like? Research emphasizing the role of ideas has often argued that the road towards an expansion of domestic demand in surplus countries is blocked by fiscally austere voters, who subscribe to the argument that domestic wage restraint is necessary to safeguard their country's export competitiveness (Sattler and Haas, 2018; Bulmer, 2014) and who love low government debts (Haffert, 2016; Matthijs, 2016; Blyth, 2013; Howarth and Rommerskirchen, 2013). This suggests that during the Eurozone crisis, voters in surplus countries should on average have opposed any expansionary measures designed to rebalance the economy, such as increases in government spending, efforts to

[2] Although we lack surveys that asked similar questions about deficit countries to respondents in Austria and the Netherlands, given the consistency voters from the three countries showed on other items, we have little reason to believe that public opinion in these countries was dramatically different.

increase wage growth, tax cuts, or new incentives for generating more private investment in the domestic economy.

However, national polls show that at the policy level, voters in surplus countries actually seemed to be very open to different forms of domestic expansion. Figures 5.3-5.5 depicts public opinion on potentially expansionary policies, which were discussed in Germany, Austria, and the Netherlands over the course of the Eurozone crisis. It shows that voters are actually quite supportive of a wide range of possible measures for domestic expansion.

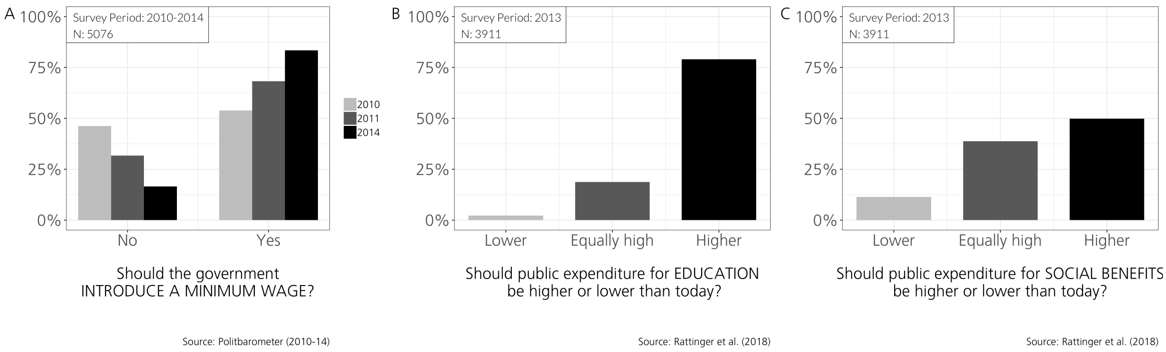


Figure 5.3: Public Opinion on Various Forms of Internal Adjustment in Germany

In Germany, for example, public opinion was not overly orthodox in terms of public spending. In a 2010 survey, more than half (55%) of respondents stated that additional tax revenues should be used for tax cuts or more government spending, whereas only 43% were in favor of using such revenues to repay debts (Infratest-dimap, 2016). The public also supported various policy measures designed to raise domestic wages. Figure 5.3a shows that between 2011 and 2013, a strong and growing majority of ultimately over 70% of respondents supported the introduction of a nationwide stationary minimum wage, which became a major policy issue during that time and was eventually implemented in 2013. Voters were also supportive of wage growth in other segments of the income distribution. In a survey from 2010, about two-thirds of all respondents supported the statement that the economic recovery should first and foremost be used to increase the wages of workers in Germany (Infratest-dimap, 2011). At the same time, German voters were also surprisingly favorable to increasing public spending. In 2013, more than 75% wanted the government to increase public investment in education, and there was even majority support for substantial increases of public spending on social welfare (see Figure 5.3b & c). This support was also very broad.

With the exception of supporters of the liberal FDP, support for the minimum wage, more spending on education, and increased expenditure for social welfare reached across party lines (Rattinger et al., 2018; Jung, Schroth and Wolf, 2015, 2013; Forschungsgruppe-Wahlen, 2016).

The public was quite positive about internal adjustment in other surplus countries as well. In Austria, three-quarters of respondents in a 2013 survey agreed that the government should lower income taxes, even if such measures would lead to higher public debt, and that the state should invest more in education (Figure 5.4b). And more than 60% of respondents felt that the government should fight unemployment even if this would lead to higher budget deficits (Figure 5.4c).

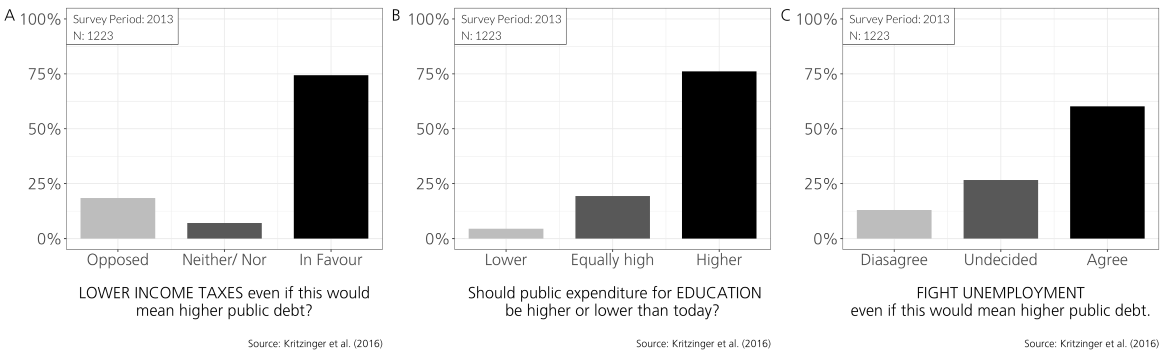


FIGURE 5.4: Public Opinion on Various Forms of Internal Adjustment in Austria

Only in the Netherlands did public opinion exhibit less enthusiasm about policies designed to foster internal adjustment. In 2012, a clear majority opposed tax cuts (Figure 5.5a), and only 25% supported increasing government spending on social welfare. As we will see later in the chapter, a possible explanation for this more restrictive stance is the fact that in 2012, the Netherlands itself struggled with rising levels of public debt and financial market pressures. However, even in these fiscally difficult times, a clear majority of voters favored more public spending in some areas, such as education.

### 5.2.3 Financing: Public opinion on financial transfers to deficit states

Voters were much more skeptical with regard to financing as a third possible crisis response. Most research on surplus country voter preferences on this issue finds that voters generally opposed the idea of redistributing money from surplus countries to deficit states (Beramendi

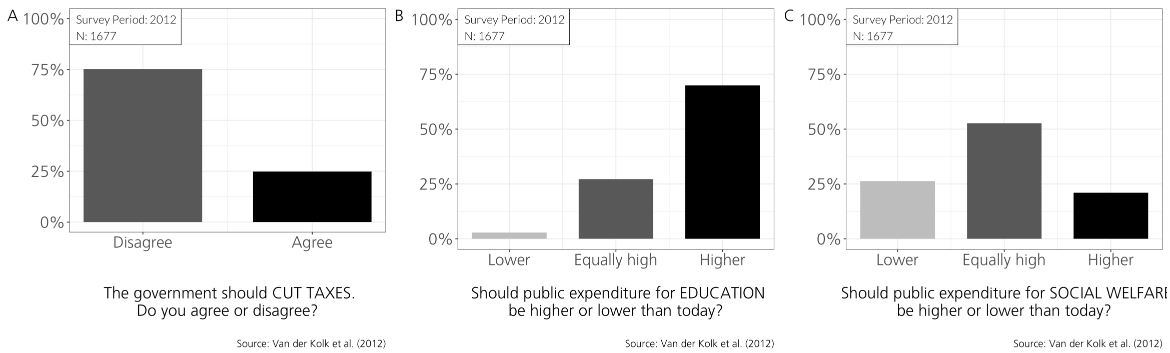


FIGURE 5.5: Public Opinion on Various Forms of Internal Adjustment in the Netherlands

and Stegmueller, 2016; Hobolt, 2016). There was considerable opposition not only to bailing out individual crisis countries (Bechtel, Hainmueller and Margalit, 2014, 2017) but also to the creation of European rescue funds (Stoeckel and Kuhn, 2018), the provision of debt reliefs for struggling countries (Rathbun, Powers and Anders, 2018), and the establishment of more institutionalized transfer mechanisms such as European unemployment schemes or Eurobonds (Dolls and Wehrhöfer, 2018; Daniele and Geys, 2015; Kanthak and Spies, 2018).

One of the reasons for the widespread opposition among voters was that, contrary to our findings for interest groups, financing preferences at the individual level seemed to have been shaped largely by noneconomic factors. Extensive research has shown that opposition to different forms of international transfers was closely linked to voters' nationalist attachment and in-group loyalty (Kuhn, Solaz and van Elsas, 2017; Bechtel, Hainmueller and Margalit, 2014; Daniele and Geys, 2015), limited altruism (Kleider and Stoeckel, 2018), conservative and Euroskeptical political attitudes (Bauhr and Charron, 2018; Stoeckel and Kuhn, 2018), and moral questions about fairness and retribution (Rathbun, Powers and Anders, 2018). Importantly, these cultural factors seemed to matter more for voters' preferences than did the individual material costs and benefits they attached to financing policies. In general, however, extensive research has shown that public opinion in surplus countries was characterized by widespread opposition to financing and that although some voters reacted to partisan cues on the issue (Stoeckel and Kuhn, 2018), rejection did not seem to be correlated with political sophistication, general political interest, or media consumption. Against this background, public opposition to transfers was relatively stable over time and, once established, hard to move into a more generous direction (Rathbun, Powers and Anders, 2018).

Yet it is also important to note that respondents were quite attentive to the type of financing provided. For example, German respondents were much more likely to support smaller bailout packages for Greece and packages in which Germany's relative share of the financial burden was smaller. Also, voters' grew more supportive of financial transfers, if bailouts were linked to strict economic conditionality (Bechtel, Hainmueller and Margalit, 2017).

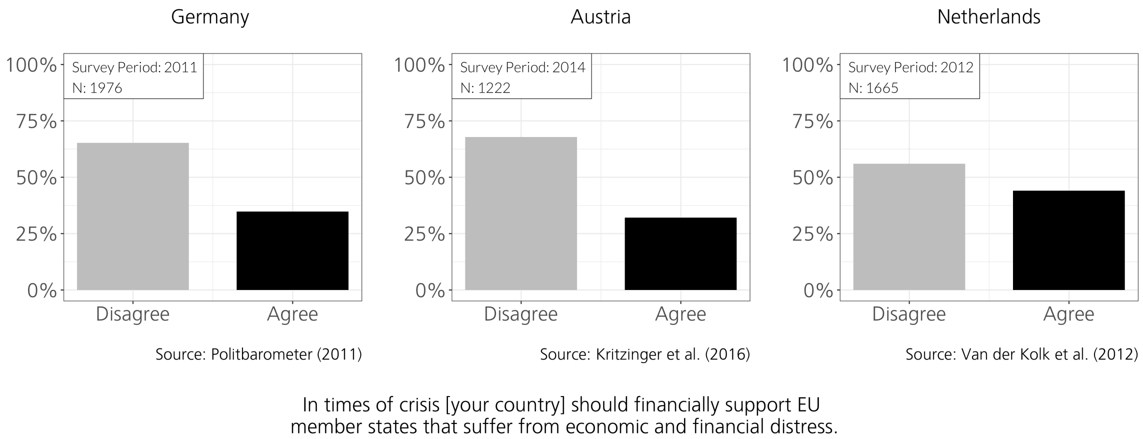


FIGURE 5.6: Public Opinion on Financing

A brief review of national polls confirms that surplus country voters were deeply skeptical about financing. Figure 5.6 shows that throughout the crisis, a clear majority of voters opposed even the general idea that their countries should financially support other member states in times of crisis. In Germany, more than 60% stated that their country should not support other member states in need. Other surveys show that the German electorate was not more forthcoming when asked about more specific forms of financing. More than 80% opposed the expansion of the European Financial Stability Facility in 2011, and more than 70% were against providing additional resources to the European Stability Mechanism in 2012 (Jung, Schroth and Wolf, 2013, 2015). Furthermore, 84% of all Germans opposed the introduction of Eurobonds, and 56% thought the German government should not have agreed to the haircut on Greek debt owed to private banks in 2011 (Jung, Schroth and Wolf, 2014, 2013). Importantly, this distribution did not differ substantially across party lines. With the exception of Green parties, a majority of supporters of all major parties opposed the general premise of international financial support in times of crisis.

Moreover, Figure 5.6 illustrates that even though much of the existing literature on financing preferences has focused on Germany, skepticism regarding international transfers also characterized public opinion in Austria and the Netherlands. Almost 70% of all Austrians and a majority of Dutch respondents opposed the provision of financial support to crisis countries.[3] Other surveys confirm this picture. In 2011, 64% of all Austrians opposed the creation of new rescue funds at the European level[4], and in the same year about 60% of Dutch voters stated that their government should stop lending money to countries in crisis (Die Presse, 2011; Maurice-De-Hond, 2011).

Overall, voters in all surplus countries throughout the crisis remained deeply skeptical of financing as a response to the Euro crisis. Although public opinion on external and internal adjustment was similar to interest groups' views regarding potential crisis policies, they differed significantly with regard to the financing strategy: whereas financing was mostly a low-salience issue for interest groups, more far-reaching reforms for international transfers and risk sharing elicited the support or at least a lack of opposition from a majority of interest groups. In contrast, financing was a salient issue for voters, and public support for redistributive measures that benefited deficit countries was quite limited.

### 5.2.4 Diverging preferences: Public opinion and interest group preferences in the Euro crisis

Table 5.1 summarizes how voters evaluated the three possible strategies followed by surplus countries in the management of the Eurozone crisis. First, the crisis did spark a significant proliferation of anti-European sentiments in all surplus countries. However, the group of voters who actually would have welcomed a breakup of the monetary union remained a clear minority, and on aggregate, surplus countries' electorate opposed external adjustment. Second, at the policy level, voters would have welcomed a wide array of measures designed to stimulate domestic demand and wage growth. Although we lack the detailed information that have on interest group preferences for comparable polices across all countries for voters,

[3]In the Netherlands, respondents were asked whether their country should "lend money to" instead of "financially support" member states suffering from economic and financial distress (NKO 2012). This wording might explain the slightly higher share of supporters.

[4]https://diepresse.com/home/wirtschaft/economist/704181/Oesterreicher-lehnen-EURettungsschirm-ab

Table 5.1: Voter and Interest Group Preferences on Crisis Strategies

| | External Adjustment | Internal Adjustment | Financing |
|---|---|---|---|
| Voters | ↓ | ↑ | ↓ |
| Interest Groups | ↓ | ↑↓ | ↑ |

national surveys show that public opinion did not constitute a major hurdle for internal adjustment.

Finally, extensive academic research and public opinion polls show that a large majority of voters in surplus countries remained very skeptical about international transfers. Given that most voters wanted to avoid a breakup of the monetary union, public opposition to financing might seem surprising. However, existing studies have also shown that in contrast to the attitudes of economic interest groups, voters' attitudes towards international redistribution and risk sharing were driven much more by nonmaterial factors such as national attachment and redemption than by cold cost–benefit analyses.

The overview in Table 5.1 also allows for a comparison of the preferences of voters with the positions of interest groups, which we analyzed in Chapter 6. Although both voters and interest groups opposed a breakup of the monetary union, their preferences diverged with respect to the other two possible crisis responses. Contrary to voters' welcoming stance, distributional conflicts about the microeconomic effects of various expansionary policies made internal adjustment a costly strategy to pursue for economic interest groups. Moreover, interest groups did not share voters' skepticism with respect to financing and would have been open to a wide array of potentially stabilizing measures.

Given the differences in preferences between voters and interest groups, it becomes important to identify the preferences responsible for setting the more vigorous constraints for policymakers and to determine how the influence of voters and interest groups differed across various policies and adjustment strategies. Before we discuss our case studies of crisis politics, the next section therefore builds on existing studies of interactions between voters and interest groups to guide our theoretical expectations.

### 5.3 Voters, Interest Groups, and Eurozone Crisis Politics in Surplus Countries

Our analyses have shown that although both voters and interest groups in surplus countries rejected external adjustment as a path to Eurozone crisis resolution, they differed significantly in their assessments of the merits of internal adjustment and financing. A key question for the study of crisis politics in surplus countries is therefore whose preferences were more influential in guiding policymakers' decisions regarding the management of the Euro crisis.

Existing research on the politics of the Euro crisis has been divided on this question. One set of studies has emphasized that public opinion and voter preferences were key determinants of the way surplus countries responded to the Eurozone's problems. These studies have built on the general idea that in democracies, politicians are responsive to the interests of potential voters, because citizens use the ballot box to hold governments and legislators accountable for their political decisions (Downs, 1957; Dahl, 1971; Esaiasson and Wlezien, 2017). As a result, democratically elected policymakers, even in the context of European policymaking, have strong incentives to turn voters' preferences into policy (Hagemann, Hobolt and Wratil, 2017; Schneider, 2018).[5] From this perspective, the decisions made by surplus country governments during the Eurozone crisis were therefore shaped primarily by domestic electoral considerations (Armingeon and Cranmer, 2018) Concerns about public opinion and rising levels of Euroskepticism made surplus countries hesitant to support international bailouts (Schneider and Slantchev, 2017) and further fiscal integration (Börzel and Risse, 2018), both of which were largely rejected by a majority of voters. Likewise, especially in Germany – the most extensively studied surplus country – the lack of internal adjustment reflected voters' fiscal conservatism, inflation aversion, and preference for balanced budgets (Bonatti and Fracasso, 2013; Haffert, 2016; Howarth and Rommerskirchen, 2013; Bulmer, 2014) but also voters' belief that current-account surpluses were a desirable sign of economic strength (Iversen and Soskice, 2018; Sattler and Haas, 2018). In sum, this first line of research has argued that surplus country policies reflected voter preferences in these countries.

[5]We leave aside here the debate about the extent to which voters' policy preferences can be shaped by elite cues (see, for example, Steenbergen, Edwards and de Vries (2007).

A second line of research has emphasized the influence of special interests on surplus countries' policy responses to the Eurozone crisis. Starting from the observation that the congruence between public opinion and policy outcomes is often limited (Matsusaka, 2010; Wlezien and Soroka, 2012), these studies have built on a large body of research on the influence of organized interest groups on political outcomes (Gilens and Page, 2014; Hacker and Pierson, 2010; Grossman and Helpman, 2001; Klüver, 2013; Dür and Bièvre, 2007). Such groups have at their disposal a wide array of means to shape policies. They can directly sway policymakers through campaign contributions (Baumgartner et al., 2009; Kalla and Broockman, 2016) and by mobilizing the electoral support of their members (Klüver, 2018). They can influence policy outcomes by providing expertise and special knowledge on complex issues (Culpepper, 2011), by shaping the (expected) economic consequences of certain policy decisions (Lindblom, 1977; Reinke, 2014), or even, especially in corporatist settings, through direct involvement in bodies of formal consultation and institutions for governmental decision-making (Schmitter and Streeck, 1991; Martin and Swank, 2012). Economic interest groups thus also shaped surplus country policymaking in the Eurozone crisis. A number of studies have argued that governments' willingness to engage in limited international bailouts was largely a tool for protecting the interests of exposed domestic banks (Tarlea et al., 2019; Frieden and Walter, 2017; Hall, 2012; Blyth, 2013). This research has maintained that the initial opposition of Germany, Austria, and the Netherlands to any form of debt forgiveness for deficit states reflected the need to buy their own banks the time to eliminate risky assets from the periphery (Thompson, 2015; Steinberg and Vermeiren, 2015). At the same time, the road towards more encompassing fiscal transfers was blocked by producer groups in export industries, which perceived more far-reaching transfers as detrimental to their interests in austere fiscal policies and wage restraint at home (Hall, 2018; Höpner and Lutter, 2018; Steinberg and Vermeiren, 2015). Similarly, these studies argue that surplus countries' unwillingness to rebalance their current accounts was rooted in a broad coalition of domestic employer groups and trade unions that depended either directly or indirectly on the performance of the export sector(Iversen, Soskice and Hope, 2016*b*; Hall, 2012). According to this literature and contrary to our findings from the previous chapter, the need to preserve competitiveness on international markets thus led a powerful coalition of both employer associations and trade unions in affected industries to lobby against any internal adjustment measures that could produce higher inflation, and a rise of the domestic wage level (Hall, 2012; Stockhammer, 2016; Moravcsik, 2012; Bonatti and Fracasso, 2013).

Existing research has thus demonstrated that both electoral concerns and interest group pressure influenced the way surplus country governments chose to manage the Eurozone crisis. At the same time, our own analysis of interest group and voter preferences shows that neither of these groups were fully successful in shaping policy outcomes in line with their preferences. Had surplus country governments cared most about implementing policies in line with voter preferences, they would have been more restrictive in terms of financing and would have instead engaged more in implementing popular expansionary policies at home. In contrast, had crisis politics been dominated exclusively by special interests, surplus countries would have been much more forthcoming about international transfers, and distributional conflicts among interest groups would have effectively ruled out any form of internal adjustment.

The fact that neither of these scenarios played out suggests that policies were the outcome of the interplay between domestic voter preferences, special interest influence, government agency and the more general domestic and international context in which the Eurozone crisis played out. An extensive literature on the interplay between voters and interest groups in the policymaking process (Stigler, 1971; Dixit and Londregan, 1996; Becker, 1983; Grossman and Helpman, 2001) shows that both voter and interest group preferences usually matters to policymakers. Second, governments' own ideas and preferences shape the policies they implement, including crisis responses. And finally, in a setting such as an international economic crisis, policymaking is also constrained by a number of contextual factors, such as economic developments or the actions and policy positions of other countries involved in crisis management. Taken together, this suggests that governments were neither the long arm of organized interests nor did they simply bow to electoral and external pressures. Instead, national political elites in surplus countries often had and made use of the considerable room to maneuver to manage the crisis within the realm of external constraints.

This raises the question under which circumstances which considerations matter most. Existing work suggests that voter preferences constrain policymakers' room to maneuver most on issues that are highly salient to voters (Armingeon and Giger, 2008; Stimson, Mackuen and Erikson, 1995; Burstein, 2003) and on which they have consistent views (Busemeyer, Garritzmann and Erik Neimanns, 2019). On such salient issues, voters are likely to monitor how candidates and parties position themselves and will hold them accountable for their standpoints in future elections (Bélanger and Meguid, 2008; Reher, 2014). For Eurozone politics, this suggests that governments' incentives to pursue policies in line with public sentiment – even if these policies were at odds with the preferences of important economic groups or their own ideological convictions - should have been particularly strong for those crisis strategies and policies to which voters played particular attention and on which they had relatively consistent views.

However, the political clout of public opinion wanes, the more disinterested voters become. The realm of the "quiet politics" (Culpepper, 2011) that characterizes nonsalient issues provides an ideal terrain for organized groups with concentrated interests (Keller, 2018). In this context, the preferences and power resources of interest groups are likely to outweigh policymakers' concerns for the preferences of largely disinterested voters. For Eurozone crisis politics, this suggests that the less salient certain policies become in the eyes of the electorate, the more the preferences of interest groups should dominate the trade-offs governments face. The salience of policies can also vary within each of the three possible crisis strategies: voters may pay attention to some aspects or forms of external or internal adjustment or financing, but not to others. This gives policymakers some room to maneuver within each of these strategies. This gives policymakers some room to maneuver within each of these strategies.

Finally, governments room to maneuver is largest, when neither voters nor interest groups push strongly in favor or against specific policies. In contexts in which voters are disinterested and in which, at the same time, interest groups are unwilling or unable to shape policy-making according to their interest, policymakers experience limited concerted pressure to follow specific polices. This opens up considerable room for governments to move in line with their own preferences and ideas. In such contexts, ideational factors such as ordoliberal convictions amongst key decision makers are likely to become an important driver of crisis politic (Dullien and Guérot, 2012; Blyth, 2002; Matthijs, 2016; Ryner, 2015). For Eurozone crisis politics, this suggests that the ideas of national political elites should have been important drivers of policymaking on issues for which issue salience was low and interest groups were disunited. Because voters and interest groups differed in their vulnerabilities to and preferences regarding various crisis strategies during the Eurozone crisis, and because these preferences had different political weights in different contexts, this suggests that we should observe considerable variation in the degree to which different interests succeeded in influencing Eurozone crisis politics in line with their preferences.

In a nutshell, we expect public opinion to shape government behavior in contexts in which adjustment strategies were saliently discussed in national politics. But in contexts in which potential adjustment strategies gained little public attention, we expect the dynamics between interest groups to be more influential. If neither voters nor interest groups push for a specific crisis resolution, we expect governments to be much more able and likely to follow their own ideas and preferences. Finally, governments are constrained not only by voters and special interests, but also by the wider policymaking context, such as the macroeconomic setting (Clark and Hallerberg, 2000; Bernhard, Broz and Clark, 2002), international processes and financial markets (Mosley, 2000, 2003; Oatley, 2011), and the negotiating positions of other countries (Lundgren et al., 2018). This suggests that surplus country policy responses to the Eurozone crisis should diverge most strongly from both voter and interest group preferences where the governments' room to maneuver was most constrained by the policymaking context.

### 5.4 Eurozone Crisis Politics in Germany, Austria, and the Netherlands

We trace this argument through comparative case studies of the crisis politics in the three biggest surplus countries: Germany, Austria, and the Netherlands. These cases are instructive because they have many similarities but also differ in important respects. All three countries positioned themselves in similar terms with regard to many European-level proposals for crisis resolution, as our analysis in Chapter 5 has shown. More generally, their crisis responses both shared important features and exhibited significant differences, especially with regard to internal adjustment. Whereas Germany did little to address its huge current-account surplus and the Netherlands even fueled its export overhang by engaging in contractionary instead of expansionary domestic policies, Austria implemented a remarkably large array of measures to strengthen domestic demand and investment. These differences are somewhat surprising, because interest groups and, to a lesser extent, voters in these countries had rather similar preferences about external and internal adjustment as well as financing.

The three countries also share a number of features that could affect the relative influence of different voter segments and interest groups. They have similar electoral institutions (Iversen and Soskice, 2006) and had comparable partisan dynamics during the crisis.[6] Interest group systems in all our cases are highly centralized, and strong peak organizations wield considerable political power. Finally, all three countries are coordinated market economies with long traditions of corporatist policymaking (Hall and Soskice, 2001; Dür and Mateo, 2013; Paster, 2013). Differences in crisis outcomes are therefore unlikely to stem from some important political or institutional dissimilarities across the three countries. However, the three countries varied considerably in their economic experiences during the crisis: whereas Germany experienced an economic boom, Austria struggled with stagnation and rising unemployment, and the Netherlands only narrowly escaped a full-fledged economic crisis of its own. Comparing crisis politics in the three countries thus allows us to explore how the preferences of voters and interest groups shaped crisis politics in different contexts.

We focus our analysis on adjustment politics between 2010 and 2016, during which time the Eurozone crisis was a prominent issue in domestic (and European) politics. To trace crisis politics in this period, we conducted 30 in-depth qualitative interviews with policymakers and interest group representatives in the three countries.[7] We selected interest groups based on their size and the importance of their members to the overall economy. We also made sure to conduct interviews with groups from all economic sectors as well as trade unions representing workers at different skill and income levels. Overall, the interviews aimed at corroborating our survey results and expanding our understanding of interest groups' positions and actions during the Eurozone crisis. We also conducted interviews with 12 policymakers, who were either legislators who had been actively involved in decisions about the crisis or high-ranking officials in the responsible departments in the ministries for finance and economic affairs. The main aim of our interviews with policymakers was to understand their perceptions of the different societal preferences and to trace how these preferences played into decision-making.

[6] During the crisis, Germany and the Netherlands were first ruled by center-right-liberal coalitions and subsequently by grand coalitions between center-right and social democratic. Austria was ruled by a grand coalition between social democrats and the center-right Austrian People's Party.

[7] Interviews in Germany took place between November 27 and December 8, 2017. Interviews in Austria and the Netherlands took place between June 18 and June 22, 2018, and July 2 and July 6, 2018.

A complete list of all our interview partners can be found at the end of this chapter. We complement the insights gained through these interviews with other sources, ranging from protocols of parliamentary debates and committee discussions to newspaper articles and other secondary sources.

The goal of our analysis is to explore how interest group and voter preferences jointly influenced surplus country policymaking during the Eurozone crisis. We examine surplus country politics with regard to each of the three different adjustment strategies in turn. We start with the strategy of external adjustment, the avoidance of which attracted a large societal consensus. We then turn to financing, where interest group and voter preferences diverged considerably but where all three countries opted for a similar policy approach. The final section discusses internal adjustment, the strategy on which interest groups were most divided and on which the three surplus countries differed considerably in terms of implementation. By examining how public opinion, interest group pressure, and contextual factors jointly influenced surplus country policymaking during the crisis, we also address the two puzzles about surplus country crisis strategies discussed at the beginning of this chapter: the fact that surplus countries kept a tight rein on all attempts to establish a permanent European-level system of financial transfers even though such measures would have been supported by economic interests and could have provided significant efficiency and insurance gains (Schelkle, 2017; Beramendi and Stegmueller, 2016) and the fact that surplus countries differed in their approaches to internal adjustment, even though similar deep distributional conflicts between interest groups about how to adjust internally existed in all surplus states.

### 5.4.1 Not an Option: External Adjustment

As we have shown throughout this book, the question of how to resolve the Eurozone crisis was hotly contested. Nonetheless, there is one issue on which a remarkable consensus emerged quickly among voters, interest groups, and policymakers: the Eurozone was to be protected. As our interest group surveys show, four out of five interest groups opposed any form of a Eurozone breakup. Although this share was somewhat lower for voters, a clear majority of voters were equally opposed to external adjustment. The Euro was also a highly salient issue for voters. A representative study from 2012 shows that almost 30% of all respondents in Germany singled out the European Union (EU) and the Euro as the most important issue the country was facing. No other issue area was mentioned with the same frequency, and in 2013, more than 85% of German voters stated that the management of the Euro crisis would matter or matter a lot for their voting decision (Jung, Schroth and Wolf, 2013, 2015). The Euro crisis was also a dominant issue in the public debates in Austria and the Netherlands. In the run-up to the Austrian election in 2014, party positions on the Euro and the EU were almost as important to Austrian voters as their stance on social and tax policies. The Euro crisis thus outranked usual evergreens of domestic political debates, such as crime or the environment (Kritzinger et al., 2016). Dutch election studies from 2012 show a very similar pattern (van Kolk et al., 2014).

Given this consensus among major domestic stakeholders, it is unsurprising that the possibility of external adjustment was scooped off the political agenda early on and without much resistance. Importantly, this happened even though external adjustment would have been in line with the ordoliberal convictions of large parts of the German, Austrian and Dutch bureaucracies and even some political decisionmakers, who were deeply convinced that keeping countries which had violated fundamental rules of sound economic policymaking in the common currency would set a dangerous precedent and weaken the monetary union in the long run (Interviews, DE4; DE11; AT9, see also Feld, Köhler and Nientiedt, 2015). Nonetheless, policymakers in Germany, Austria, and the Netherlands never seriously considered external adjustment in the form of either leaving the monetary union or pushing deficit countries to leave. None of the mainstream parties in surplus countries regarded calling for a breakup of the union as a viable political position, and although ministries in all countries planned for a breakup, these steps were always regarded as preparing for a worst-case scenario (Interviews, DE9; DE10; DE12; AT7; AT9; NL5; NL6). Several policymakers argued that politically, there was simply "no alternative" to keeping the Eurozone together, not only because the expected market upheavals and potential threat to the stability of the common currency would have hurt crucial economic sectors but also because there was little popular backing for any measure that could risk the stability of the union (Interviews DE12; AT9; NL6).

The only exception to this uniform rejection of a Eurozone breakup occurred after the election of the Greek anti-austerity party Syriza in early 2015 – and especially when the Greek people voted in a referendum against the terms of a proposed bailout agreement in July of that year. To the extent that markets had priced in a potential exit of Greece and because Eurozone policymakers – in line with the dominant ordoliberal reading of the crisis in these countries (Young, 2014; Dullien and Guérot, 2012) - feared that giving Greece softer conditionality terms as a result of the referendum might create a dangerous precedent (Frieden and Walter, 2018), a number of high-ranking policymakers in the ministries of finance in Austria, the Netherlands, and especially Germany concluded that Greece should abandon the common currency if it failed to comply with program conditionality (Interviews DE11; AT9; Mody 2018). Pressure rose to the degree that the German finance ministry circulated a proposal for a temporary Greek "time-out" from the common currency among members of the Eurogroup, and some media outlets even reported on meetings among conservative European finance ministers who planned to force the Tsipras government to leave the Eurozone.[8] This tough stance and the fact that an ordoliberal reading of the right way to handle Greece gained considerable clout in this debate is not completely surprising if we remember that among all possible options for external adjustment, a Greek exit from the Eurozone was the least opposed option across all societal groups and that, as we discuss below, harsh conditionality was how surplus country policymakers had sold financing to their skeptical voters. Moreover, at the time, most important economic interest groups considered the direct adverse economic effects or possible contagion risks from a Grexit to be quite limited (Interviews, DE1; DE2; AT1; NL1). As such, the episode underlines the core argument that policymakers acted in line with voter and interest group preferences with regard to external adjustment.

### 5.4.2 The Vocal Politics of Financing in Surplus Countries

Whereas there was strong support for avoiding a breakup of the Eurozone among both voters and interest groups, they diverged in their preferences when it came to financing. Voters in all three countries were strongly opposed to virtually any form of financial transfers from surplus to deficit countries, and this issue was highly salient, especially in the early years of the crisis. In contrast, most interest groups were quite open or at least indifferent to various forms of international transfers. Whereas financing was a low-salience issue for some interest groups, some special interests got heavily involved in this issue. Financial sector groups

[8] http://www.spiegel.de/international/germany/schaeuble-pushed-for-a-grexit-and-backed-merkel-into-a-corner-a-1044259.html

in particular invested heavily in lobbying for bailouts and against debt cuts in all three surplus countries in the early years of the crisis (Interviews DE6; AT3; NL2; Thompson, 2015; Steinberg and Vermeiren, 2015).

The strong popular opposition to financing put surplus country governments in a difficult position. On the one hand, the context of the accelerating crisis meant that without financial support, the countries hit hardest by the crisis were likely to default and crash out of the Eurozone, an outcome that no one – neither voters, interest groups, nor policymakers themselves – wanted. On the other hand, the issue of financing was so heavily contested among the public that it severely limited policymakers' room to maneuver to consent to intra-European transfers.

Vocal popular opposition influenced surplus countries' willingness to provide financing in two main ways. First, it led to serious delay in and political conflicts about the creation and approval of financing measures. One striking example is the hesitation of the German government to back the first bailout package for Greece in the spring of 2010. As several analyses as well as our own interviews show, electoral concerns were one of the key reasons for Germany's foot-dragging in agreeing to a bailout (Schneider, 2018; Schneider and Slantchev, 2017). Motivated by the upcoming elections in North Rhine-Westphalia and the unpopularity of the bailouts among large voter segments, Angela Merkel decided to postpone any decision on Greece until after the election in order to secure success for her party in the elections. By the time the German government finally came around, the original costs of the bailout had more than doubled (Schneider and Slantchev, 2017). This episode turned out to be representative of the constraints surplus countries faced in financing decisions more generally (Zimmermann, 2014; Bulmer, 2014; Schimmelfennig, 2015). For example, strong public opposition to international transfers also led Dutch Prime Minister Mark Rutte to pledge"not a cent more for Greece" as a central campaign promise in the run-up to the Dutch 2012 national elections. This statement, at least according to a number of domestic observers, substantially contributed to his election victory and made it all the more costly to walk back from it for the third Greek bailout in 2015 (Interview NL6).[9]

Second, the intense politicization of financing and domestic popular opposition also affected the form of financing that surplus country governments were willing to provide. Both

[9] https://www.ecfr.eu/article/dutch_drama_over_greek_crisis_4004

bureaucrats and party members involved in the crisis mentioned that the decisions they made always partly hinged on what was politically possible without evoking resistance from a watchful public (Interviews DE9; DE10; AT9; NL6). At the same time, most policymakers we interviewed stated that the stability of the domestic financial sector had been a key concern that motivated their actions during the crisis years (Interviews DE12; AT9; NL6). Policymakers thus confronted a difficult situation. Voters wanted the Euro to survive, and they did not want to finance the European periphery, yet they were also in no way willing to support another bailout of domestic banks, which they had disapproved of heavily during the 2009 global financial crisis (Goerres and Walter, 2016). At the same time, a default of the European crisis countries was likely to trigger just that (or a major domestic banking crisis), because surplus country governments had heavily invested in these countries (Ardagna and Caselli, 2014), and the financial industry therefore lobbied heavily for providing deficit countries with the funds to repay their debts.

Policymakers resolved this problem by devising financing in a way that not only pushed the potential costs for taxpayers far into the future, but also allowed them to channel the necessary funds to their domestic banks via a bailout of the peripheral countries and more indirect measures, such as allowing the Target2 balances in creditor states' central banks to grow (Frieden and Walter, 2017; Blyth, 2013). This feat was achieved by subjecting the bailouts to significant conditionality and by the introduction of a strong rhetoric about "profligate" debtor states who had caused the entire crisis and the need to pursue this path out of "solidarity" and in order to safeguard "European integration" (Degner and Leuffen, 2015; Wendler, 2014; Matthijs, 2016).

A large body of literature has shown that the emphasis on strong conditionality to avoid moral hazard, the design of strict rules in making financing available and the moralizing framing of the bailouts was in line with and inspired by an ordoliberal interpretation of the sources and potential cures for the Eurozone crisis (Young, 2014; Dullien and Guérot, 2012; Feld, Köhler and Nientiedt, 2015; Matthijs and Blyth, 2015). However, it is important to note that this narrative remained dominant because few political actors challenged it. Although most interest groups viewed several financing variants rather favorably, the low salience of the issue for their members meant that they hardly got involved in this debate.[10] Even

[10]With the exception of the financial sector.

major opposition parties, which often disagreed heavily with the ordoliberal interpretation of the crisis amongst members of conservative parties and the bureaucracy (Interviews DE9, AT7, NL5), did not prominently discuss financing alternatives to bailouts. For example, although the German Greens and the Social Democratic Party (SPD) at times discussed alternative financing regimes and less austerity-oriented rescue programs, they strategically avoided campaigning on these issues given the overwhelming popularity of the hard stance that Angela Merkel's CDU took (Interviews DE9; Bauer and Steiner, 2015; Korte, 2013). In German parliamentary debates, the far-left Die Linke was the only party to call attention to the fact that that the bailouts were large redistributive programs from German and peripheral taxpayers to German and other creditor states' banks (Wonka 2015). In a similar vein, except for the right-wing populist FPÖ, most Austrian opposition parties invested little political capital in challenging the government's position on limiting international transfers and tying bailouts to strict conditionality (Dolezal, 2014; Dolezal and Zeglovits, 2014). Even changes in government coalitions did little to move surplus countries' restrictive position on financing. After the 2012 election, the traditionally more Keynesian Social Democrats took over the Dutch ministry of finance. However, although according to staff members this occasionally led to a change in tone on European issues, it did not have any effect on the substantive position of the ministry (Interview NL6).[11] Similarly, the German position on financing remained unchanged when the Social Democrats entered the grand coalition led by Angela Merkel in 2013 (Zohlnhöfer and Saalfeld, 2017).

Other forms of financing quickly faded as options once the dominant bailout narrative had taken hold. At the beginning of the crisis, bureaucrats in the Dutch Ministry of Economic Affairs, for example, had discussed a wide range of European reforms, including institutionalized forms of financing and permanent risk-sharing measures. However, they quickly scrapped these ideas when it became apparent that they would be politically impossible to implement (Interview NL6). Public opposition to financing also caused the Austrian government to backpedal on its initial support for the idea of Eurobonds. Although Chancellor Werner Faymann occasionally expressed some support for the issuance of common bonds, public skepticism and the skepticism of his conservative coalition partner eventually led him

[11] A couple of years later, the social democratic finance minister, Jeroen Dijsselbloem, famously emphasized his position on international transfers by describing Southern European budgeting as the fiscal equivalent of spending money on "liquor and women." https://www.politico.eu/newsletter/brussels-playbook/politico-brussels-playbook-terror-in-london-dijsselbloem-strategy-mogherinis-putin-problem/

to postpone the idea to "some point in the future."[12] And policymakers from all surplus countries emphasized that it became increasingly difficult to get popular support for the use of taxpayer money to help countries that according to much of the public discourse were themselves responsible for the troubles they faced (Interview DE9; AT7; AT9; NL5; NL6).

Our focus on the diverging interests of different societal actors, thus, complements existing accounts of the politics of financing in surplus countries. In line with the structuralist interpretation that surplus countries restricted financing and tied it to strict conditionality in order to push the burden of adjustment on to deficit states and safeguard the competitiveness of their export sectors (e.g. Hall, 2018; Iversen and Soskice, 2018), our interviews showed that most employer associations and industry groups in surplus countries supported imposing austerity and structural reforms on to deficit states (Interviews, DE2; DE4; AT2; NL1).[13] However, the same groups would have been open to a wide range of additional financing measures and generally invested little political capital in shaping financing outcomes. Export interests were thus not at the heart of hesitant financing. Similarly, in line with the constructivist emphasis on the importance of ordoliberal ideas in guiding surplus countries' approach to financing (e.g. Blyth, 2013; Matthijs, 2016), our case studies have shown that many policymakers were convinced of the merits of forcing crisis countries into fiscal prudence and structural reforms (Interview DE11; AT9). However, even for those that did not held these ideas, the political room to maneuver was very limited by vocal popular opposition.

Overall, the broad support for keeping the Eurozone together, vocal and widespread public skepticism regarding international transfers, targeted lobbying by the financial sector, and little opposition from other interest groups thus came together to shape surplus countries' hesitant, piecemeal, and highly restrictive approach to financing.

### 5.4.3 Context Matters: The Politics of Internal Adjustment

Voters and interest groups diverged not only in their assessment of financing, but also in their evaluation of the desirability of internal adjustment policies. Although interest groups were open to internal adjustment in principle, they were deeply divided about how to adjust

[12] https://derstandard.at/1319183544762/Oesterreich-strikt-dagegen-Europa-hofft-auf/Heilung-durch-Eurobonds;https://orf.at/v2/stories/2122109/2122049/

[13] Importantly, however, trade unions – even in the export sectors – fiercly rejected such measures.

internally. In contrast, voters in all surplus countries viewed expansionary economic policies at home positively. Nevertheless, the three big surplus countries pursued very different responses to their domestic economic crises. Whereas Germany did little to boost the domestic economy, Austria implemented a range of expansionary policies. Finally, the Netherlands initially did not just resist internal adjustment, but even implemented contractionary measures that fueled rather than decreased the Dutch current-account surplus – and then ignored all international calls to reduce its export overhang.

We examine the politics of adjustment for each country separately, focusing on how domestic economic developments influenced the salience of economic reforms during the crisis and on how public opinion and interest groups jointly influenced the politics surrounding internal adjustment. Our analysis suggests that the differences in surplus countries' willingness to pursue internal adjustment stem from the fact that domestic economic reforms were not equally important to voters in all surplus countries. Distributional conflicts among interest groups resulted in nonadjustment in contexts in which voters paid little attention to economic policies. The more salient such reforms became in the eyes of the electorate, however, the more likely policymakers became to override the gridlock among interest groups. This dynamic suggests that the politics of adjustment is characterized by a paradox: the better a country's economy is doing, and hence the easier it is economically to pursue internal adjustment, the less likely a government is to push for internal adjustment, because there is no political pressure to do so.

### Germany

Domestic economic reforms were not a major political issue in Germany throughout most of the crisis period. Contrary to most other European countries, Germany weathered the Eurozone crisis well. Although the country had been hit hard by the global financial crisis in 2008, its export sector quickly recovered thanks to the low exchange rate of the Euro and rising demand for its products, especially from Chinese and US markets (Dustmann et al., 2014). As a result, Germany experienced robust economic growth and declining unemployment rates throughout the crisis. Financial investors intent on reducing their exposure to crisis-ridden deficit countries rushed into the safety of German assets, reducing the government's debt service costs and contributing to a conversion of Germany's budget deficit into a surplus in 2012 (see Figure 5.7). Given this fiscal space, Germany was thus in a prime position to engage in meaningful internal adjustment (Elekdag and Muir, 2014).

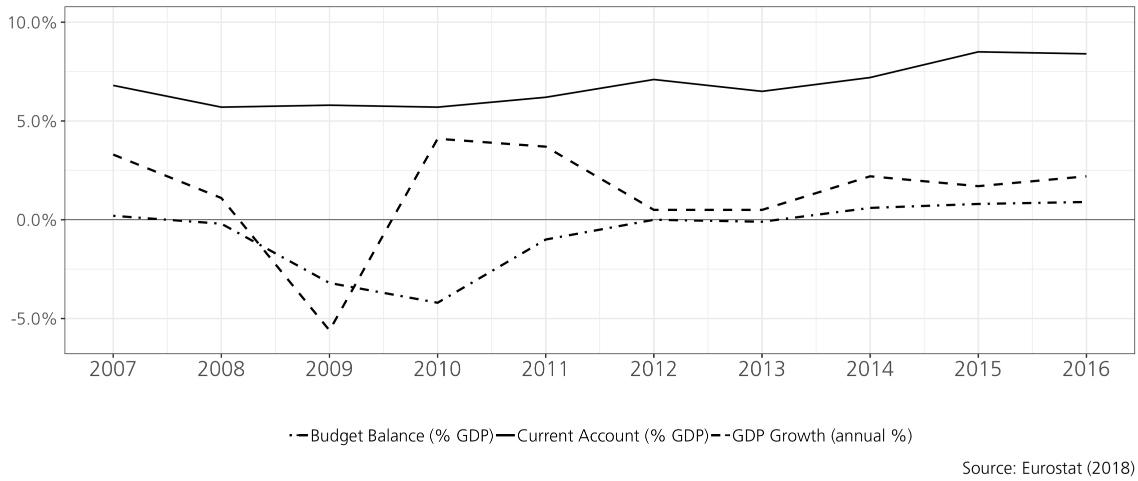


FIGURE 5.7: Macroeconomic Developments in Germany

Ironically, however, the thriving economy also decreased domestic pressure to engage in domestic expansion. Figure 5.8 plots the salience voters attached to the domestic economy, measured as the share of German citizens that singled out the economy or taxation as the most important issue their country was facing. It shows that the salience of domestic economic issues decreased constantly over the span of the Euro crisis. By 2015, less than a quarter of the German public thought that economic issues should be at the forefront of political priorities. This suggests that even though voters liked a wide range of expansionary policies, these preferences did not gain much political traction. In the run-up to the national election in 2013, for example, a large majority of Germans evaluated the state of the domestic economy very positively. Unsurprisingly, economic issues played only a minor role during the campaign. None of the main opposition parties campaigned on a broad-based spending or investment program (Steinbrecher, 2014; Korte, 2013). Only Die Linke and the Green Party made Germany's large current-account surplus the main subject of several parliamentary motions and often linked the existence of trade imbalances to low wages and a lack of public investment and spending in Germany. However, although they agreed in principle with much of the international criticism directed at Germany, both parties did little to publicly campaign on the matter. At the same time, interest groups and economic experts who were sympathetic to the international criticism of Germany's large current-account surplus found it difficult to effectively communicate their concerns (Interviews DE1; DE7; DE8; DE13). Arguments about the effect of German reforms on disparities in the Eurozone had little effect on public opinion (Frech, König and Osnabrügge, 2015), which is perhaps unsurprising given the overwhelming public satisfaction with the contemporary state of affairs.

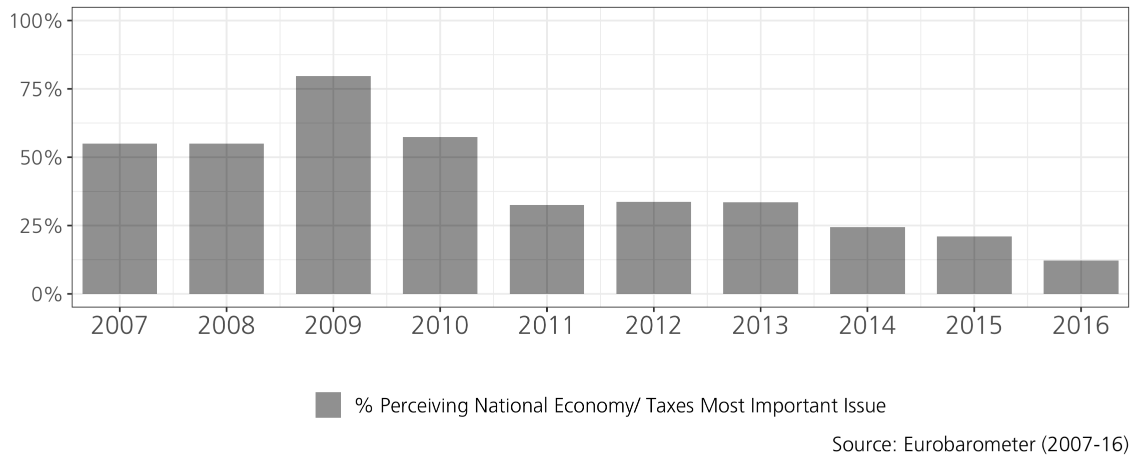


FIGURE 5.8: Salience of Economic Issues for German Voters

In this context, debates about the current-account surplus and possible adjustment policies took place mainly among a small circle of political experts and economic interest groups and never entered the wider public discourse (Interview DE1). In this context, distributional conflicts between interest groups about the microeconomic effects of various adjustment measures often inhibited meaningful reforms. For example, throughout the crisis both the International Monetary Fund (IMF) and the European Commission called for Germany to fundamentally reform its corporate tax regime in order to increase private investment and reduce capital outflows (IMF, 2013, 2011; European-Commission, 2014). This call was largely in line with the partisan program of the economically liberal FDP, who until 2013 was part of the ruling coalition and had made the abolition of local business taxes a core objective of their legislative period (Rixen, 2015). A wide range of large employer organizations and trade associations supported the reform. However, all attempts to pass it into law failed due to intense opposition from the Association of German Cities, who feared the loss of an important source of revenues, from a wide range of trade unions, and from the fiscally conservative wing of the CDU.[14] In the end, the two coalition governments that ruled Germany

[14]https://www.bundestag.de/blob/409640/0f335317888ca03d9b08c4c93ac83d03/wd-4-247-10-pdf-data.pdf;http://www.dgb.de/presse/++co++e9732abe-e1ce-11df-6211-00188b4dc422

during the crisis implemented fewer tax reforms than had any other German government since 1965 (Rixen, 2019). Opposition from trade unions as well as craft associations also kept deregulatory reforms of the domestic service economy off the political agenda (Bandau and Dümig, 2015), even though they were often proposed as another means to spur domestic demand and investment (Interviews DE5; DE8; DE11; IMF 2015).

Distributional conflicts among economic interest groups also contributed to the limited expansion of public investment. One of the striking factors discussed in the previous chapter was that most economic interest groups favored more government spending on investment. Their opinions diverged, however, on what kind of investment should be prioritized and how such investment should be financed. When in 2014 the SPD-led ministry summoned an expert committee on infrastructure investment composed of economic experts, industry and employer associations and trade unions to devise policy suggestions, these differences led trade unions to distance themselves from the committee's final report and limited the political momentum of the document in the social democratic ministry (Interview DE8; DE13).[15] Against this background, expanding public investment never became a political priority, and the rate of public investment in Germany remained one of the lowest in the entire EU (Rixen, 2019).[16]

Distributional conflicts about the specifics of internal adjustment thus rendered domestic expansion politically difficult. Nonetheless, given that a majority of interest groups supported the overall goal of boosting domestic demand, the question remains why policy makers did not invest more political capital into building compromises that would have made internal adjustment attractive for a diverse set of groups. Considering our findings from the previous chapter, a joint package of policies aimed at simultaneously strengthening wage growth, lowering corporate taxes and financing public investment through diverse funds, for example, might have been able to garner support from a larger number of organized interests.

[15] https://www.wallstreet-online.de/nachricht/9013536-bericht-einigung-fratzscher-kommission/investitions-masterplan

[16] Besides these distributional conflicts, policymakers also stressed the importance of institutional bottlenecks as an important hurdle for more public spending. Especially in Germany, fiscal federalism means that most public investment – for instance in education or road infrastructure – has to be undertaken at the state or even the municipal level. Although the German finance ministry – especially since the onset of the refugee crisis in 2015 – had incrementally increased some of the federal resources provided to the subnational level, a lack of planning and execution capacities in German municipalities has made it difficult to effectively realize potential investments (Interview DE11; DE12; DE13). For a similar interpretation, see Hassel (2017).

The absence of such a compromise becomes less puzzling when we also consider the agency of the government itself, however. Distributional conflicts amongst interest groups combined with the low salience of economic reforms for voters provided German political elites with considerable of room to maneuver in terms of domestic economic policymaking. In this context, the economic convictions and crisis interpretation of policymakers became especially relevant. In line with the dominant ordoliberal reading of the sources of the crisis in German economic academia as well as major economic institutions such as the Bundesbank and the finance ministry (Dullien and Guérot, 2012; Young, 2014; Matthijs and McNamara, 2015), German political elites were largely convinced that internal adjustment in Germany would be futile (Interviews DE10; DE11, DE12). Especially amongst members of the ruling CDU, the current-account surplus was mainly perceived as the outcome of market forces and a manifestation of the competitiveness of the German economy (Interviews DE4; DE10; DE11). International calls for reducing the export overhang were interpreted as attempts to deflect from necessary adjustment in deficit states (Interviews DE10; DE11, DE12, see also Zimmermann, 2014) as reducing the surplus was seen as ignoring the related debt and competitiveness problems in the South. Given robust growth rates in Germany, some policymakers also feared that an additional stimulus would simply overheat the economy and endanger the country's standing on international markets (Interviews DE1; DE4; DE10; DE11; DE12).[17] As one member of parliament put it, "I simply cannot understand how making us as uncompetitive as the South would really help the Eurozone" (Interview DE10). Finally, whereas some ministerial bureaucrats generally acknowledged the German current account position to be problematic, they did not believe that any reasonable form of macroeconomic demand management would have enough impact on domestic consumption and investment to change it (Interview DE11, DE12).[18]

Given that the lack of salience of economic reforms for the German public and the gridlock between organized interest groups, this interpretation remained largely unchallenged

[17] This interpretation was also supported by a number of academic studies in Germany, amongst them, for example, a special report by the German Council of Economic Experts, a institutionalized group of economics which regularly consults the German government on economic policies. https://www.sachverstaendigenrat-wirtschaft.de/fileadmin/dateiablage/gutachten/jg201415/JG14_06.pdf.

[18] Again, this interpretation finds the support of a range of prominent German economists. See for example, https://www.bmwi.de/Redaktion/DE/Publikationen/Ministerium/Veroeffentlichung-Wissenschaftlicher-Beirat/gutachten-wissenschaftlicher-beirat-wirtschaftspolitische-probleme-der-deutschen-leistungsbilanz.pdf?___blob=publicationFile.

(Interviews, DE1; DE7; DE9; DE13). As a result, the government implemented domestic economic policies in line with these ideological convictions. Internal adjustment remained limited and the German current-account surplus continued to grow throughout the crisis period, as Figure 5.7 shows.

Nonetheless, the German case also demonstrates that internal adjustment measures become more feasible when voters start to care about them. The only meaningful economic policy reforms that occurred during the crisis period were labor market reforms, more specifically the introduction of a minimum wage. Ever since its broad-based labor market liberalization in 2005, Germany had experienced a rapid expansion of the low-wage sector. The rising number of the working poor made the introduction of a statutory minimum wage an increasingly salient topic in the German domestic debate (Mabbett, 2016). By 2013, it had become a major issue in the political arena and enjoyed overwhelming public support, especially among SPD voters (95% in support) and the CDU (79% in support) (Jung, Schroth, and Wolf 2015). Moreover, the major trade unions engaged in a broad and coordinated campaign in favor of the minimum wage, and the SPD turned its introduction into a central campaign promise (Zohlnhöfer and Saalfeld, 2017). This high salience of and support for the issue among voters eventually trumped the fierce opposition from industry groups and employer associations and led to the implementation of a central internal adjustment policy, a statutory minimum wage, in 2013.

Austria

Boosting the domestic economy became much more important for Austrian policymakers. Although Austria sailed through the crisis better than many other Eurozone countries, the downturn in the rest of the Eurozone still weighed heavily on the country's economy. In contrast to German manufacturers, the Austrian export sector depended heavily on markets in Italy and Eastern Europe, and the slump in demand from these countries therefore took a heavy toll on many export-oriented industries (Pudschedl, 2013). At the same time, economic insecurity and comparatively low wage growth also stalled domestic demand and investment throughout much of the crisis (OECD, 2015). As a result, the Austrian economy only narrowly escaped a recession in 2012 and 2013, and growth remained below 1% until 2015 (OECD, 2015Figure 5.9). Sluggish growth also resulted in rising unemployment. Although it started from comparatively low levels, the jobless rate increased throughout the crisis and had reached levels not seen since the 1950s by the end of 2015.[19] At the same time, public finances had suffered from the costs of bank bailouts and anticyclical policies implemented in response to the global financial crisis in 2008 and 2009 and therefore missed the EU budget deficit target of 3% of GDP in 2010 (see Figure 5.9). The Austrian government therefore implemented a range of budget cuts and tax increases especially in the beginning of the crisis (Lehndorff, 2012)

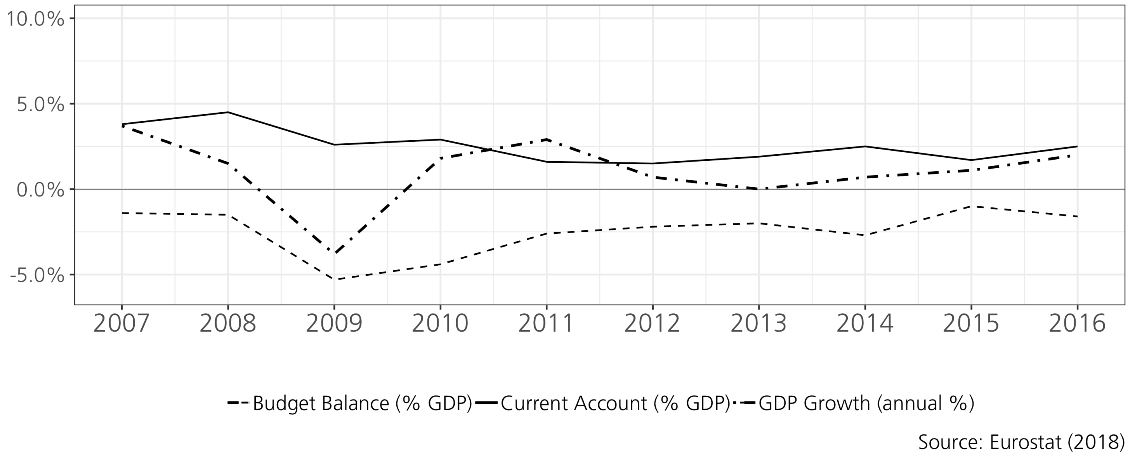


FIGURE 5.9: Macroeconomic Developments in Austria

These bleak economic developments turned the domestic economy into a salient issue for Austrian voters. Figure 5.10 shows that throughout the peak years of the Eurozone crisis (2010–2013), approximately every second Austrian respondent rated the national economy and fiscal policy as the most important issue facing the country. In the run-up to the election of 2013, more than 90% of the respondents to the representative survey stated that spurring the economy was an important issue (Kritzinger et al., 2016). Unsurprisingly, the question of how to reform the economy dominated much of the political debate during the crisis (Dolezal 2014). The issue of economic growth and unemployment was one of the most covered topics in national media, and both the conservative Austrian People's Party (ÖVP) and the Social Democratic Party of Austria (SPÖ) focused their national campaigns almost exclusively on their respective visions of regaining growth and jobs (Dolezal and Zeglovits, 2014).

[19] https://derstandard.at/2000030145081/Oesterreich-Arbeitslosigkeit-naehert-sich-500-000er-Marke

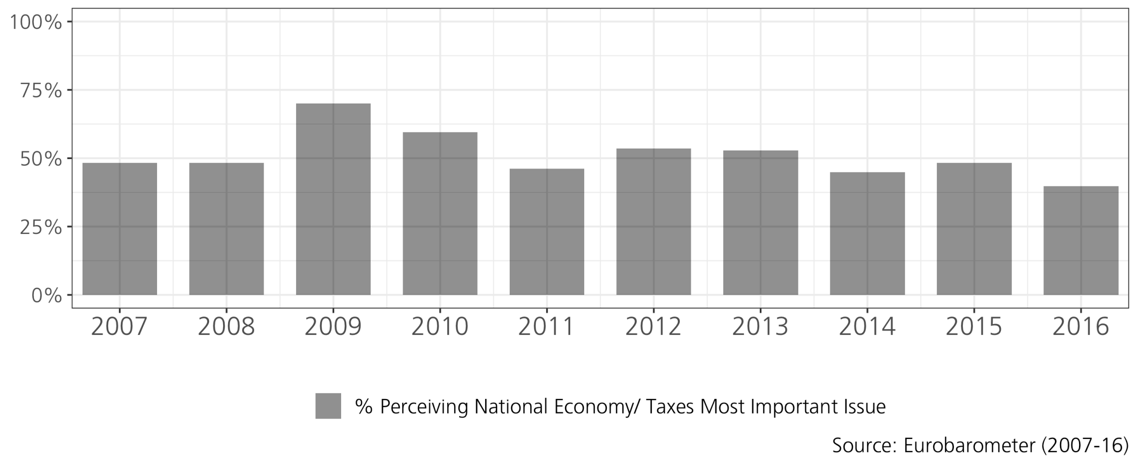


FIGURE 5.10: Salience of Economic Issues for Austrian Voters

The high salience of economic reforms in the domestic debate thus put Austrian policymakers under immense pressure to spur domestic job growth, demand, and investment (Interviews AT1; AT7; AT8). As in Germany, economic interest groups shared this goal but disagreed profoundly about how it should be achieved. However, because public pressure did not allow Austrian officials to sit on their hands, they not only disregarded considerable ideological reservations amongst large parts of the conservative ÖVP, whose economic program for a long time had centered on fiscal consolidation and reducing the size of the state in the economy (Dolezal and Zeglovits, 2014). The government also forced interest groups to compromise. In 2013, for example, the Austrian grand coalition agreed on a large stimulus package for the domestic economy. Among other measures, the package aimed at supporting the struggling construction sector and increased resources available for public childcare and healthcare services. Whereas employer associations in the construction sector praised the package, which also gained broad support among all major trade unions, the measures were heavily criticized by the powerful Federation of Austrian Industries, who publicly maintained that the measures would lead to market distortions and would put excessive strain on public finances.[20] However, given the high popularity of the program (less than 35% of voters opposed it) and the imminence of the national elections, this opposition of the major industry group gained little political momentum (Interview AT8).[21] Public demands for

[20] https://www.wko.at/branchen/gewerbe-handwerk/bau/Bauinnung-spezial–Dez-2014.pdf; https://orf.at/v2/stories/2188508/2188507/

[21] https://www.profil.at/home/alpine-bau-umfrage-50-konjunkturpaket-alpine-pleite-361177

expansionary measures also led the Austrian government to increase spending in other areas. Among other initiatives, the grand coalition employed additional resources to promote broadband connections in rural areas and substantially raised the fiscal space available to municipalities across the country (Interview AT7). As a consequence, public investment in Austria remained above 3% of GDP and was substantially higher than investment rates in all other European surplus countries (Eckerstorfer and Prammer, 2017).

In addition to increasing expenditures, the Austrian government sought to stimulate domestic demand through tax cuts. The biggest reform was a broad-based modification of income taxes in 2015. It amounted to cutting taxes by about €5 billion per year and was one of the single biggest tax reductions in recent Austrian history (Baumgartner and Kaniovski, 2015). The long negotiation process that preceded the reform was marked by intense conflicts between the Austrian Economic Chamber and a number of large trade unions, which fought extensively about the specifics of the reform and were especially polarized on various forms of countervailing measures (Interviews AT1; AT4). In the end, the government forced the social partners into a compromise that offset some of the costs by a substantial increase of the marginal income tax rates but refrained from the parallel implementation of wealth and inheritance taxes that employee representatives had called for (Interviews AT1; AT4).[22] Although the final tax reform was evaluated negatively by a large set of companies, public pressure to implement tax relief and stimulate domestic demand was so high that it outweighed initial concerns especially on the part of the ÖVP.[23]All these reforms occurred despite the fact that Austrian policymakers for a large part held very similar ideas about the sources and possible solution of the Eurozone crisis as their German counterparts. As in Germany, the Austrian crisis discourse largely focused on the culprits of state debts lacking competitiveness in deficit countries (Leupold, 2015). Similarly, most Austrian government and party officials explicitly disagreed with the idea that adjustment in countries like Germany or Austria would contribute stabilizing the monetary union and stressed that, at the international level, they had always defended Germany against its international critics (Interviews, A7; A8; A9). However, given the large public demand for a fiscal stimulus this

[22] https://www.ots.at/presseaussendung/OTS_20150707_OTS0189/leitl-zu-steuerreform-einige-/entschaerfungen-fuer-betriebe-erreicht-jetzt-sind-neue-konjunkturimpulse-noetig

[23] https://derstandard.at/2000018304405/Neos-Umfrage-Unternehmer-mit-Steuerreform-unzufrieden

general agreement with the ordoliberal tenets of German crisis interpretation did not keep the Austrian government from engaging in substantial internal adjustment.

The dire prospects of the Austrian economy coupled with high salience of domestic reforms and popular pressure to counter low growth and increasing unemployment, thus, lead the Austrian government to override distributional conflicts among interest groups and ideological reservations of the conservative coalition partner. As a result, Austria implemented a range of expansionary measures during the crisis years.

### The Netherlands

Finally, the Dutch crisis experience can be divided into two distinct phases. Starting form 2011, the Netherlands experienced the most severe economic problems of all surplus countries in the monetary union. The reasons for this downturn were manifold, ranging from a loss of European export markets to gloomy domestic consumption due to the bursting of a big housing bubble that put the heavily indebted private households in the Netherlands on a prolonged deleveraging path. As a result, the Dutch economy slid into a recession in 2012 and 2013, and unemployment rose from less than 3% in 2008 to almost 8% in 2014. Public deficits, which had dropped from a small surplus to a deficit of about 5% of GDP by 2009, improved only slowly, and only in 2013 did the drop fall below the 3% target of the EU again (see Figure 5.11). During these years, the Dutch experience was often seen as evidence that the Eurozone crisis would eventually creep to the north, and commentators as well as government officials were deeply concerned that financial markets could start turning against the Netherlands as well (Interviews NL7; NL6).[24] However, from 2014 onwards, house prices started to recover alongside foreign demand for Dutch exports (especially from the neighboring Germany). As a result, the second half of the Eurozone crisis was characterized by a steady economic recovery in the Netherlands. Only three years after the recession, unemployment in the Netherlands was again lower than the levels with which Austria struggled, and the Dutch economy started to grow faster than Germany's (CPB, 2016).

The salience of domestic economic issues in the political arena closely followed this trajectory of recession and recovery. Figure 5.12 shows that between 2012 and 2014, more

[24] https://www.nytimes.com/2012/05/02/business/global/euro-stress-crosses-border-into-netherlands.html; https://www.reuters.com/article/us-dutch-economy/the-dutch-europes-apostles-of-austerity/feel-the-economic-pain-idUSBRE97F07F20130816; https://ftalphaville.ft.com/2016/06/16/2166258/why-is-the-netherlands-doing-so-badly/.

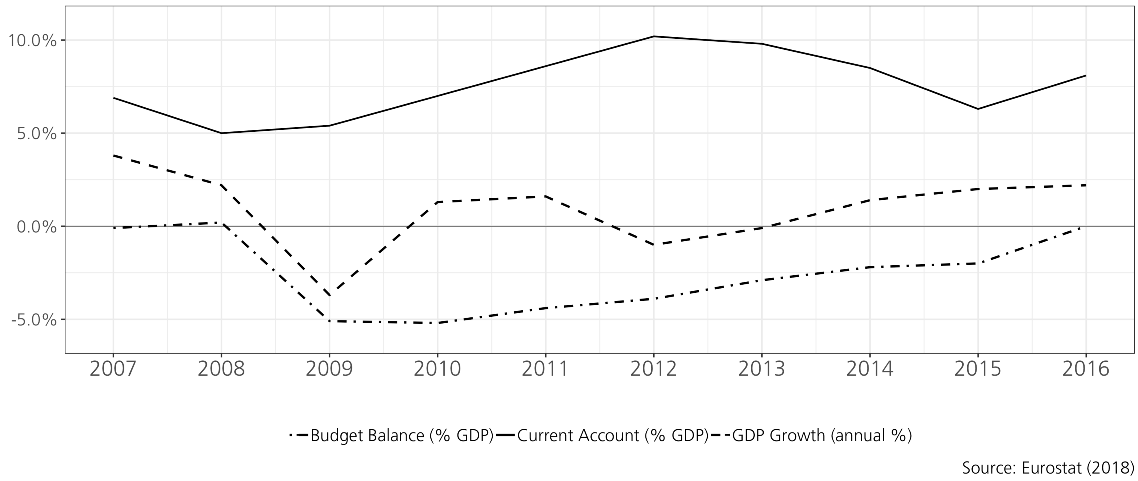


FIGURE 5.11: Macroeconomic Developments in the Netherlands

than 70% of Dutch citizens thought that the economy was the Netherlands' most important problem. Economic issues dominated politics in those years. In 2012, the coalition government, consisting of the liberal People's Party for Freedom and Democracy (VVD) and the conservative Christian Democratic Appeal, had to call for snap elections, because the far-right PVV, who so far had supported the minority government, refused to back a new budget plan that contained €16 billion of fresh austerity measures (Evans, 2013). In the following election, the economy was the central concern for most voters (CPB, 2015), and parties campaigned mainly on their respective visions for the breadth and depth of measures that should bring down the deficit (Van Kessel, 2015; Pirro and van Kessel, 2017). Over time, however, as growth and employment recovered, the salience of economic issues waned. As Figure 5.12 shows, by 2016 less than 25% of Dutch respondents thought of economic problems as a priority, and in the 2017 elections, economic issues played a very limited role (Van der Meer, Van der Kolk and Rekker, 2017).

What did the bifurcated crisis experience mean for the politics of internal adjustment? In the early phase of the crisis, characterized by a large budget deficit, cuts to public spending, and weak domestic demand, debates about internal adjustment were largely absent from the political arena, even though the Dutch current-account surplus increased substantially in the early 2010s. On the one hand, there were domestic reasons for this absence. Prioritizing fiscal consolidation was not only in line with the ruling VVD's fiscally conservative ideology and the feeling that the government needed to practice what it had been preaching to deficit

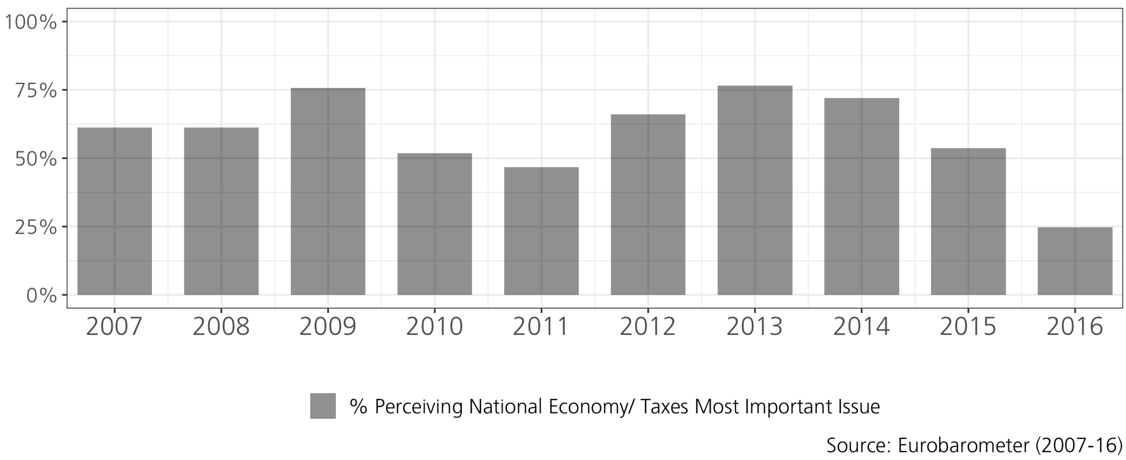


FIGURE 5.12: Salience of Economic Issues for Dutch Voters

countries since the outbreak of the crisis (Interviews NL6; NL7; NL8). It was also supported by a majority of voters (Maurice-De-Hond, 2012) as well as almost all employer associations and even the biggest trade unions. In addition, international pressure focused on the budget deficit. At several points between 2012 and 2014, the European Commission demanded that the Netherlands extend its austerity program so as not to fall subject to an excessive deficit procedure. At the same time, none of the country reports and recommendations by either the Commission or the IMF mentioned the current account as an area of priority. Without international pressure to rebalance, and because voters and a majority of interest groups largely agreed on the need for austerity, reducing the current-account surplus was not on the table at all in the early years of the crisis (Interviews NL1; NL3).[25]

Debates about internal adjustment became more prevalent from 2015 onwards as the economy recovered. With the budget deficit under control, both the IMF and the European Commission started to call on the Dutch government to take steps to reduce the country's big export overhang (IMF, 2016*b*, 2017*b*, 2018*b*; European Commission, 2016). Because most economic groups agreed that infrastructure in the Netherlands was already in a relatively good state and that the need for further public investment was therefore limited. The domestic discussion about the current account surplus, thus, focused mainly on decreasing wages and high savings in the corporate sector as the main drivers of the large current-account

[25] Parliamentary documents between 2010 and 2016 also show that during the early period of the crisis, only the far-left Socialist Party (SP) regularly called attention to the large export overhang as a problem and linked it with calls for more domestic expansion and higher wages.

surplus (Boumans and Keune, 2018; Interview NL1; NL4). The political debate about how to rebalance was once again characterized by distributional conflicts between different interest groups. Trade unions emphasized that the labor share of income had been declining in the Netherlands for years. They therefore called for a re-regulation of labor markets in an effort to strengthen the bargaining power of workers, achieve higher wage growth, and as a result increase domestic demand (Interview NL4; FNV, 2016). These measures were, however, fiercely opposed by most employer associations, which instead advocated a wide range of tax cuts that they deemed necessary to incentivize private investment in the Netherlands by unlocking the huge amounts of savings that had been accumulated in the corporate sector (Interview NL1; VNO-NCW, 2016). These debates about the current-account surplus did not take place in the wider public, which is unsurprising given that by 2015, the salience of domestic economic reforms was rapidly decreasing (see Figure 5.12). Several parliamentary meetings with social partners on the subject gained little media attention (Interview NL5; Boumans and Keune, 2018). Without public backing for one side of the debate over the other, these conflicts among the most important interest groups meant that interest groups got bogged down in distributive struggles. Without much external pressure from either voters or interest groups, the Dutch government had ample room to navigate the discussion about internal adjustment in accordance with its own preferences. Given that most economic policymakers in the Netherlands disagreed with the idea that the Dutch current-account surplus was of any particular relevance to the stability of the monetary union[26] and, after years of crisis, simply had their priorities elsewhere (Interviews NL6; NL7), discussions about internal adjustment measures thus never gained much political momentum. The current-account surplus continued to balloon.

### 5.4.4 Internal adjustment in Eurozone surplus countries

Overall, our analysis of the domestic politics of (non)adjustment in surplus countries yields two main insights. First, our study of crisis politics indicates that the lack internal adjustment in surplus countries was rooted in distributional conflicts about how to adjust rather than a broad societal consensus to avoid expansionary measures. The resulting lack of strong

[26]This interpretation that was, also shared by the Dutch Bureau for Economic Policy Advice, which is part of the Ministry for Economic Affairs and Climate Policy and regularly publishes influential policy papers. https://www.cpb.nl/sites/default/files/publicaties/download/cpb-policy-brief-2015-05-causes-and-policy-implications-dutch-current-account-surplus.pdf

interest group and voter pressure for expansionary policies opened up room for policymakers to implement domestic economic policies in line with the ordoliberal ideas prevalent amongst political elites in surplus countries. However, when the national economic context made domestic economic policies a salient issue and support for a expansionary policy became more vocal and concerted, ordoliberal ideas became much less influential for surplus country policymaking, as our analysis of the Austrian case suggests.

Second, our analysis also implies that the lack of adjustment in core countries is much less structurally engrained than it is often assumed. Especially when voters start to care about increasing domestic growth and employment, public opinion is likely to pressure policymakers into expansionary measures even against the opposition of powerful interest groups. However, this also suggests that politics of adjustment in surplus countries are characterized by a paradox: the better a country's economy is doing, and hence the easier it is economically to pursue broad adjustment measures, the less likely such voter pressure is to occur and the more likely it becomes that the distributional conflicts among interest groups result in non-adjustment.

### 5.5 Conclusion

Why did surplus countries in the Euro crisis not shoulder a larger share of the burden of adjustment? Why did they invest huge sums in short-term bailouts but refuse to build up a more extensive and permanent system of transfers and mutual risk sharing? And why did they allow their current-account surpluses to keep rising while at the same time demanding that crisis countries take painful measures to reduce their deficits? Our book's central premise is that a full understanding of the politics of the Eurozone crisis requires an understanding of how key societal actors and policymakers evaluated all potential crisis responses, including those not chosen. In this chapter, we have therefore analyzed how voters positioned themselves with regard to external adjustment, internal adjustment and financing and how their preferences and policymakers' ideas interacted with the preferences of economic interests groups in shaping crisis outcomes.

A number of key finding stand out. First, neither interest groups, voters, nor policymakers wanted to risk a crashing of the Eurozone. Given this broad societal consensus to keep the Eurozone together, external adjustment was never seriously considered as a politically viable crisis strategy in any of the surplus countries we studied. Second, the politics surrounding financing illustrate how difficult it is to do politics on the back of bad options. On the one hand, financial industries lobbied heavily for bailouts and against debt reliefs and other economic interest groups were supportive of a range of financing measures but did not make them a political priority. On the other hand, voters remained deeply skeptical about international transfers and, given the huge salience of the Euro crisis in domestic debates, were difficult to ignore. Trying to satisfy both sides, policymakers only engaged in the forms of financing that were absolutely necessary to keep the Eurozone from crumbling, which further fuelled market tensions and crisis tendencies in deficit states.

Finally, domestic rebalancing was characterized by what we call the paradox of internal adjustment in surplus countries. Voters' general support for domestic expansion translated into policies only in contexts in which bad domestic economic developments put the spotlight on the necessity of economic reforms. If voters cared enough, they pressured policymakers into overriding interest group gridlock and disregarding their own ordoliberal convictions and to engage in meaningful adjustment policies. However, when the economic state of affairs was a low salient issue among voters, distributional conflicts between interest groups resulted in a political stalemate that allowed governments to pursue policies in line with ordoliberalism. This typically resulted in non-adjustment. Domestic politics, thus, led those countries, which could have contributed the most to stimulating European growth and reducing the imbalances within the monetary union, to become the least-likely candidates for internal adjustment.

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# Supplementary Materials

## 5.A List of Interview Partners

**Germany**

| | |
|---|---|
| Interview DE1 | Dr. Klaus Günter Deutsch, **Bundersverband der Deutschen Indsutrie** , Head of Department Research, Industrial and Economic Policy |
| Interview DE2 | Dr. Michael Stahl, **Gesamtmetall**, Head of Education and Economic Policy |
| Interview DE3 | Eckhart Rotter, **Verband der Automobilindustrie**, Head of Department Press |
| Interview DE4 | Dr. Peer-Robin Paulus, **Die Familienunternehmer**, Head of Politics and Economics |
| | Dr. Daniel Mitrenga, **Die Familienunternehmer**, Head of Europe and Federal States |
| Interview DE5 | Dr. Alexander Barthel, **Zentralverband des Deutschen Handwerks**, Head of Economic, Energy and Environmental Politics |
| Interview DE6 | Dr. Reinhold Rickes, **Deutscher Sparkassen- und Giroverband**, Head of Economic Research |
| Interview DE7 | Florian Moritz, **Deutscher Gewerkschaftsbund**, Head of European Economic Politics |
| Interview DE8 | Dr. Dierk Hierschel, **Vereinte Dienstleistungsgewerkschaft**, Trade Union Secretary in the Department of Economic Policy |
| Interview DE9 | Joachim Poß, **Social Democratic Party of Germany**, former Member of Parliament: Committee for European Affairs, Finance Committee |

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|---|---|
| Interview DE10 | Prof. Dr. Heribert Hirte, **Christian Democratic Union of Germany**, Member of Parliament: Committee for European Affairs, Finance Committee |
| Interview DE11 | Dr. Ludger Schuknecht, **Federal Ministry of Finance**, Chief Economist and Head of the Directorate General Fiscal Policy and International Financial and Monetary Policy |
| Interview DE12 | Felix Probst, **Federal Ministry for Economic Affairs and the Environment**, Ministerialrat |
| Interview DE13 | Dr. Claus Michelsen, **Deutsches Institut für Wirtschaftsforschung**, Head of Forecasting and Economic Policy |

**Austria**

| | |
|---|---|
| Interview AT1 | Dr. Christoph Schneider, **Wirtschaftskammer Österreich**, Head of Department for Economic Affairs |
| Interview AT2 | Dr. Christian Helmstein, **Industriellenvereinigung**, Chief Economist |
| Interview AT3 | Michael Ernegger, **Verband Österreichischer Banken und Bankiers**, Deputy Secretary General Retail Baning |
| Interview AT4 | Dr. Markus Marterbauer, **Arbeiterkammer Österreich**, Head of Department for Economic Affairs and Statistics |
| Interview AT5 | Karl Goldberg, **Österreichische Verkehrs- und Dienstleistungsgewerkschaft**, Department for Economic Affairs |
| Interview AT6 | Kerstin Repolusk, **Die Produktionsgewerkschaft**, Department for Economic Policy |
| Interview AT7 | Dr. Christoph Matznetter, **Social Democratic Party of Austria**, Member of Parliament: Committee for Finance and Budget Committee |
| Interview AT8 | Dr. Christina Burger, **Federal Ministry for Science, Research and Economic Affairs**, Department for Economic Policy |

| | |
|---|---|
| Interview AT9 | Harald Waiglein, **Federal Ministry of Finance, Head of the Department for Economic Policy, Financial Markets and Customs** |

**Netherlands**

| | |
|---|---|
| Interview NL1 | Thomas Grosfeld, **Confederation of Netherlands Industry and Employers**, Department for Top Sector Policies |
| Interview NL2 | Bart van Leeuwen, **Nederlandse Vereniging van Banken**, Head of Communication Department |
| Interview NL3 | Sander van Golberdinge, **Detailhandel Nederland**, Director |
| Interview NL4 | Irene Laureijs, **Federatie Nederlandse Vakbeweging**, Economic Policy Advisor |
| Interview NL5 | Renske Leijten, **Socialistische Partij Nederland**, Member of Parliament: Committee for European Affairs, Budget Committee |
| Interview NL6 | Focco Vijselaar, **Federal Ministry for Economic Affairs**, Director for Economic Policy, Chief Economist |
| Interview NL7 | Michel Heijdra, **Federal Ministry of Finance**, Director Foreign Financial Affairs Directorate |
| Interview NL8 | Niels Redeker, **Federal Ministry of Finance**, Head of the European Union Division |

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